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CITATIONS

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In the Supreme Court of the United States

OCTOBER TERM, 1956

No. 89

AUTOMOBILE CLUB OF MICHIGAN, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the Tax Court (R. 144–169) is reported at 20 T. C. 1033. The opinions in the Court of Appeals (R. 190–219) are reported at 230 F. 2d 585.

JURISDICTION

The judgment of the Court of Appeals was entered on February 17, 1956 (R. 190). The petition for a writ of certiorari, filed on May 15, 1956, was granted on October 8, 1956 (R. 219). The jurisdiction of this Court rests upon 28 U. S. C., Section 1254.

QUESTIONS PRESENTED[1]

1. Whether the Commissioner, having in 1943 published a correct ruling of general application that automobile clubs were not tax-exempt as social clubs, could in 1945 properly revoke prior erroneous rulings in favor of taxpayer and direct it to file tax returns for 1943 and 1944.

2. Whether assessment of deficiencies for 1943 and 1944 was barred by the statute of limitations.

3. Whether membership dues, received by taxpayer under a claim of right and without restriction, were includible in its gross income for the years in which such dues were received.

STATUTE AND REGULATIONS INVOLVED

Sections 41, 42 (a), 52 (a), 54 (a), (b), and (f), 101 (9), 275 (a) 276 (a) and (b), and 3791 (b) of the Internal Revenue Code of 1939, and Sections 29.52-1, 29.101-1, 29.101-2 (a), (b), (c), (e), (g), (i), and (j), and 29.101 (9)-1 of Treasury Regulations 111, are set forth in the Appendix, *infra*, pp. 67-76.

STATEMENT

The facts relevant on this review, as stipulated (R. 16-105) and found by the Tax Court (R. 146-151, 156-157, 159-161), may be summarized as follows:

INTRODUCTION

The taxpayer was incorporated under the laws of Michigan on July 21, 1916. It was organized as a

[1] The questions are here stated in the order in which they were discussed by both courts below. In its brief before this Court, taxpayer has stated the third question first.

nonprofit corporation without capital stock and has never paid any dividends. (R. 146.)

During the taxable years involved, the number of taxpayer's members was approximately as follows:

1943	212,865
1944	224,092
1945	243,630
1946	261,695
1947	244,904

Taxpayer's by-laws provided for annual meetings of its members. Until some undisclosed time prior to March 15, 1947, twenty-five members constituted a quorum. Effective March 15, 1947, the presence of 10% of taxpayer's members was required to constitute a quorum. Taxpayer did not engage in or conduct any social activities. (R. 147-148.)

Taxpayer's members were of three classes—honorary, life, and active. Honorary membership was limited to twenty-five members, including certain government officials and other persons named by the board of directors. Honorary members paid no dues and had no voting rights. Life membership was obtained by an active member paying $250 at one time. Life members were exempt from the payment of future dues and assessments but continued to have all the rights of active members. Active memberships were open to persons of good moral character over sixteen years of age. Active members paid dues of $10 annually, except that as of October 1, 1946, such amount was increased to $12. (R. 147.)

During the taxable years involved, the amount of dues which taxpayer collected from its members and its other principal items of revenue (including revenue from advertising in an organization periodical, the *Motor News*) were as follows (R. 69, 159):

	Dues	Rental income	Interest earned	Motor News advertising
1943	$2,126,437.50	$36,936.48	$34,420.90	$47,829.50
1944	2,237,017.04	37,623.25	40,429.10	59,266.55
1945	2,430,543.97	39,956.48	[illegible],051.06	71,713.14
1946	2,744,897.65	58,567.52	41,374.74	81,452.50
1947	2,914,028.76	48,756.48	39,425.75	82,148.00

Taxpayer's purposes or objects were stated in its Articles of Association, and in its by-laws as of January 1, 1940, as follows (R. 146):

> To promote and foster the healthy growth of the automobile industry; to secure the adoption and enforcement of reasonable and useful traffic ordinances and motor vehicle laws; to promote the establishment and construction of permanent highways for traffic; to interest automobile owners and drivers in the principles of "Safety First" as applied to automobile traffic; to promote touring and to obtain and furnish touring information and obtain the necessary signboarding of public highways; and to cooperate in any work or movement which may tend to benefit the automobile driver, user, owner or manufacturer, and the automobile industry in general.

In January 1941, taxpayer's by-laws were amended to provide that its funds should be used only to accomplish these objectives and should not inure or be distributed to its members (R. 42, 147).

Taxpayer's principal activity was the rendering of services to its members. These services included: furnishing emergency road service, supplying touring information, keeping members informed of matters of interest through publication and distribution of the *Motor News,* securing for members the benefits of

affiliation with the American Automobile Association, and providing for the purchase of automobile insurance by members.[3] (R. 62–63, 148.)

In its tax returns, taxpayer reported earned surplus and undivided profits at the beginning of each of the taxable years as follows (Schedule L, Exs. 13, 15; R. 68B, 76, 89):

1943	$920,193.84
1944	1,046,230.85
1945	1,300,471.81
1946	1,385,905.01
1947	1,255,251.46

CLAIMED EXEMPTIONS FROM TAXATION FOR 1943 AND 1944

During the early part of 1934, taxpayer inquired of the Commissioner whether it was exempt from capital stock tax imposed by Section 215 of the National Industrial Recovery Act. In answer, the Commissioner informed taxpayer that it was first necessary to determine whether taxpayer was exempt from federal in-

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[3] Among taxpayer's expenditures in rendering its services during the taxable years in issue were the following (Schedule K, Exs. 13, 15, 17, 19, 20; R. 71, 84, 182, 183, 184A, 185, 186A, 187, 188A, 189):

	1943	1944	1945	1946	1947
Emergency road service	$548,364.58	$592,912.60	$875,279.60	$851,720.69	$885,960.07
Maps and guides	16,072.65	27,346.22	25,551.14	135,979.09	38,150.10
Printing, stationery and office supplies	216,471.78	225,998.25	232,183.83	288,638.24	335,250.55
Postage and mailing	49,051.22	56,724.60	59,501.02	60,278.57	55,985.68
AAA dues	52,969.25	55,776.00	60,660.50	65,176.75	61,001.50
Accident policy premiums	66,240.98	65,738.00	56,018.46	109,702.25	232,653.75
Commissions	178,129.39	135,775.77	160,697.12	201,959.87	116,580.66
Compensation of officers	35,100.00	35,496.02	36,086.25	37,855.70	37,915.00
Salaries and wages	542,247.01	577,533.56	678,667.51	803,996.89	912,317.04
Portion of expense charged to Detroit Automobile Inter-Insurance Association	159,919.27	171,999.74	189,753.91	221,375.72	271,225.63

	Dues	Rental income	Interest earned	Motor News advertising
1943	$2,126,437.50	$36,936.48	$34,420.90	$47,829.50
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	1943	1944	1945	1946	1947
Emergency road service	$548, 364. 58	$592, 912. 60	$875, 279. 60	$851, 729. 69	$885, 960. 07
Maps and guides	16, 072. 65	27, 346. 22	25, 551. 14	135, 979. 09	58, 150. 10
Printing, stationery and office supplies	216, 471. 78	225, 998. 25	232, 183. 83	288, 638. 24	335, 250. 55
Postage and mailing	49, 051. 22	56, 724. 69	59, 501. 02	60, 278. 57	55, 885. 68
AAA dues	52, 969. 25	55, 776. 00	60, 660. 50	65, 176. 75	61, 001. 50
Accident policy premiums	66, 240. 98	65, 738. 00	56, 018. 46	109, 702. 25	232, 653. 75
Commissions	178, 129. 59	135, 775. 77	160, 697. 12	201, 959. 87	116, 580. 66
Compensation of officers	35, 100. 00	35, 496. 02	36, 086. 23	37, 855. 70	37, 915. 00
Salaries and wages	542, 247. 01	577, 533. 56	678, 667. 51	803, 996. 89	912, 317. 04
Portion of expense charged to Detroit Automobile Inter-Insurance Association	159, 919. 27	171, 999. 74	189, 753. 91	221, 375. 72	271, 225. 63

come taxation under the provisions of Section 103 of the Revenue Act of 1932. Accordingly, the Commissioner requested taxpayer to supply certain information concerning its operations, a copy of its financial statement for 1933 showing assets and liabilities, and a classified list of its receipts and disbursements. Taxpayer replied, enclosing a balance sheet showing its assets and liabilities as of April 30, 1934. On June 11, 1934, the Commissioner wrote taxpayer that on the basis of evidence submitted it had been concluded that taxpayer was entitled to exemption under the provisions of Section 103 (9) of the Revenue Act of 1932 and the corresponding sections of prior revenue acts; that taxpayer therefore was not required to file returns for 1933 and prior years; and that under the provisions of Section 101 (9) of the Revenue Act of 1934 taxpayer would not be required to file returns so long as there was no change in its organization, its purposes, or methods of doing business. (R. 148–149.)

In September 1937, the Commissioner sent taxpayer a questionnaire requesting certain information concerning its claim for exemption under Section 101 (9) of the Revenue Act of 1936. Taxpayer filled in the questionnaire and returned it to the Commissioner with a letter and a copy of its financial statement as of December 31, 1936. On July 5, 1938, the Commissioner wrote taxpayer that, since it appeared that there had been no significant change in its form of organization or activities, the previous ruling of the Bureau holding it exempt from filing returns of income was continued. (R. 149.) Section 101 (9) of the Revenue Act of 1936 was subsequently adopted as

Section 101 (9) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 69).

On July 11, 1943, there was published in the Internal Revenue Bulletin an opinion by the Chief Counsel of the Bureau of Internal Revenue holding that the American Automobile Association, the national association of local clubs like the taxpayer, was not tax-exempt under Section 101 (9) of the 1939 Code. G. C. M. 23688, 1943 Cum. Bull. 283. As grounds for this conclusion, the Chief Counsel's opinion pointed out (1) that fellowship among members did not play a material part in the life of the organization, and (2) that the association was not organized and operated exclusively for pleasure, recreation, and other *similar* nonprofitable purposes. The ruling also expressly revoked, or recommended revocation of, previously published exemption rulings with respect to local automobile clubs. Taxpayer was a member of the American Automobile Association and during each of the taxable years paid that organization annual dues varying in amount from approximately $53,000 to approximately $65,000. (Schedule K, Exs. 13, 15, 17, 19, 20; R. 20, 182, 183, 185, 187, 189.)

On May 12, 1945, the Commissioner wrote taxpayer stating that the Bureau of Internal Revenue was reconsidering the question of the exemption of automobile associations from federal income taxation in the light of the Chief Counsel's opinion. Taxpayer was requested to furnish the information called for in an exemption affidavit form which was enclosed. By letter dated June 11, 1945, taxpayer complied with

the Commissioner's request and enclosed the executed exemption affidavit together with a copy of taxpayer's articles of incorporation and by-laws and a copy of its balance sheet as at December 31, 1944. (R. 149–150.)

On July 16, 1945, the Commissioner wrote taxpayer as follows (R. 66–67):

> Reference is made to the information submitted by you for use in determining your status for Federal income tax purposes in view of the opinion expressed in G. C. M. 23688, C. B. 1943, 283.
>
> Under date of June 11, 1934 you were held entitled to exemption from Federal income tax under the provisions of section 103 (9) of the Revenue Act of 1932 and the corresponding provisions of prior revenue acts, which ruling was affirmed July 5, 1938, under the provisions of the Revenue Act of 1936.
>
> The information recently submitted by you shows that your activities consist of providing travel information and service, rendering emergency road service, publishing the Motor News, locating automobile parts for members' cars to keep them in service, providing safety education in public and parochial schools, organizing and equipping school patrols and providing traffic surveys for Michigan cities in the interest of safety. Your income is derived from membership dues, interest on investments, and advertising in the Motor News. It is expended for rendering services to your members.
>
> Section 101 (9) of the Internal Revenue Code provides for the exemption of:

> "Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder."

Prior revenue acts carry similar provisions.

This office holds that the term "club" as used in the above section of law contemplates commingling of members, one with the other in fellowship. Thus, an organization should be so composed and its activities be such that fellowship among the members plays a material part in the life of the organization in order for it to come within the meaning of the term "club".

The evidence submitted shows that fellowship does not constitute a material part of the life of your organization and that your principal activity is the rendering of commercial services to your members.

It is, accordingly, held that you are not a club "organized and operated exclusively for pleasure, recreation and other non-profitable purposes", within the meaning of section 101 (9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections. Furthermore there is no other provision of law under which an organization of your character can be held to be exempt from Federal income tax.

Bureau rulings of June 11, 1934 and July 5, 1938 are hereby revoked.

In view of all the facts and circumstances in your case it is held, with the approval of the Secretary of the Treasury, that you will not

be required to file income tax returns for years beginning prior to January 1, 1943. You are, however, required to file returns for the year 1943 and subsequent years.

Thereafter taxpayer filed income and excess profits tax returns for the calendar years 1943 and 1944 under protest on the ground that it was exempt from tax. (R. 151.)

PERIOD OF LIMITATIONS ON ASSESSMENT OF DEFICIENCIES FOR 1943 AND 1944

On August 12, 1944, taxpayer filed with the Collector for the District of Michigan, for the calendar year 1943, Treasury Department Form 990, an annual return which under Section 54 (f) of the 1939 Code (Appendix, *infra*, pp. 68–69) was required to be filed by organizations exempt from income tax under Section 101 of the 1939 Code. On May 17, 1945, taxpayer filed a like form for the calendar year 1944. These returns showed gross income and receipts and disbursements and contained statements of assets and liabilities at the end of the respective years. Such returns were not the returns required by Section 52 (a) of the 1939 Code (Appendix, *infra*, pp. 67–68) from corporations subject to tax under Chapter 1 of the Code and did not provide sufficient data from which taxpayer's income and excess profits tax liability for 1943 and 1944 could be computed and assessed. (R. 156.)

Taxpayer's income and excess profits tax returns (Forms 1120 and 1121) for the calendar years 1943 and 1944 were filed on October 22, 1945. On August 25, 1948, acting under Section 276 (b) of the 1939

Code (Appendix, *infra*, p. 70), taxpayer and the Commissioner entered into consent agreements which provided that the amounts of any income, excess profits, or war profits taxes for the taxable years ended December 31, 1943, and December 31, 1944, could be assessed at any time on or before June 30, 1949. On May 23, 1949, they executed consent agreements which provided that such taxes could be assessed at any time on or before June 30, 1950. The notice of deficiency forming the basis of this proceeding was mailed to taxpayer on February 20, 1950. (R. 156–157.)

ACCRUAL OF MEMBERSHIP DUES

The annual dues collected by taxpayer from its members were deposited in a general bank account maintained with the National Bank of Detroit. This was an account in which all money received by taxpayer was deposited. At no time were the dues segregated from taxpayer's general funds or deposited in a bank account other than the one general account in which all of its other receipts were deposited. (R. 159–160.)

Upon receipt of a member's dues, taxpayer set aside $1 to pay for a subscription to *Motor News*. In the case of a new member brought in by one of taxpayer's solicitors or employees, a commission of $2.50 was paid to the person bringing in the member. (R. 160.)

Prior to March 15, 1947, taxpayer's by-laws provided that a member whose annual dues remained unpaid for 30 days after becoming due was subject to suspension from the privileges offered by taxpayer. If a member failed to pay his dues within 30 days

after notice of his suspension, he ceased to be a member and became liable for two months' dues as well as the expense of collecting them. Any member who resigned forfeited all his rights and interests in taxpayer's property and assets. A new by-law effective March 15, 1947, provided for termination of membership by death, by resignation, by nonpayment of dues, or upon other reasonable cause by written notice to the member, such notice of termination to be accompanied by a check for the unused portion of annual dues as determined by taxpayer's board of directors. Taxpayer's board of directors has never adopted a resolution fixing the amount, or providing a formula for ascertaining the amount, of a refund to be paid to persons who ceased to be members of taxpayer. (R. 160.) Although prior to March 15, 1947, taxpayer's by-laws did not provide for the refunding of a portion of annual dues upon the termination of a membership, it had been taxpayer's policy since about 1924 to refund a portion of the unearned dues upon such termination. However, there was no inflexible rule under which the amounts of such refunds were computed.[3] (R. 160.)

[3] During the years in issue, the amount of dues collected and the amount actually refunded due to cancellation of memberships were as follows (R. 142–143, 159):

	Dues Collected	Refunds Due to Cancellation of Memberships
1943	$2,126,437.50	$13,204.33
1944	2,237,017.04	13,347.97
1945	2,430,543.97	17,492.74
1946	2,744,897.65	21,867.71
1947	2,914,028.76	24,778.87

Membership dues were paid in advance for one year. When a member's dues were received, taxpayer credited the amount of such dues to an account carried as a liability account and designated "Unearned Membership Dues." During the first month of membership and each of the following eleven months, one-twelfth of the amount paid was credited to an income account designated "Membership Income." This practice with respect to membership dues has been followed by taxpayer since 1934 and the income from membership dues reported by taxpayer in its returns for 1943 through 1947 was computed in this manner. (R. 160–161.) During those years, as a result of this practice, the dues which taxpayer actually received exceeded the dues reported as income by the following amounts (Ex. 23, R. 106A):

1943	$132,742.37
1944	82,879.34
1945	77,198.81
1946	145,919.02
1947	64,523.82

Taxpayer's returns for each of the years 1943 through 1947 were prepared on the basis of a calendar year and the accrual method of accounting. (R. 161.)

The Commissioner determined that the entire amount of membership dues received by taxpayer during the years involved should be reported as income for the years in which received. (R. 161.)

PROCEEDINGS BELOW

On the basis of the facts set forth above, the Tax Court, in an opinion reviewed by the full court, held: (1) that the Commissioner, having correctly ruled

dues upon such termination. However, there was no inflexible rule under which the amounts of such refunds were computed.[3] (R. 160.)

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in July 1945 that taxpayer was not tax-exempt as a social club within the meaning of Section 101 (9) of the 1939 Code, properly revoked prior erroneous rulings that taxpayer was exempt under corresponding sections of the Revenue Acts of 1932 and 1936 and properly required payment of taxes for 1943 and 1944; (2) that the applicable statute of limitations did not bar assessment of deficiencies for 1943 and 1944; and (3) that the amount of membership dues paid to taxpayer during the taxable years should be accrued as income for the respective years in which received.[4] (R. 146–151, 156–157, 159–162.)

On appeal, the Sixth Circuit, Judge McAllister dissenting on the first issue, affirmed the decision of the Tax Court. (R. 190–219.)

SUMMARY OF ARGUMENT

I

The first issue, which relates only to the years 1943 and 1944, concerns the validity of the action taken by the Commissioner in July 1945 when, in accordance with the general ruling published in 1943 that automobile clubs were not tax-exempt as social clubs, he advised taxpayer of his determination that it was not tax-exempt, revoked prior inconsistent rulings in favor of taxpayer, and directed taxpayer to file tax returns (as distinguished from information returns) for 1943 and 1944. Taxpayer concedes that, under the applicable provisions of the Internal Rev-

[4] A fourth issue decided by the courts below, relating to the amounts allowable as depreciation deductions, is not presented for decision here.

enue Code of 1939, it was not tax-exempt for the years 1945, 1946, and 1947. From this concession, it necessarily follows (1) that taxpayer, whose activities remained substantially the same, was likewise not tax-exempt in 1943 and 1944 under the 1939 Code provisions, (2) that the published 1943 ruling was correct, and (3) that the prior inconsistent rulings in taxpayer's favor were erroneous. In discussing the question whether in July 1945 the Commissioner could properly revoke these earlier erroneous rulings and assess taxes for 1943 and 1944, it is pertinent to consider the nature of the earlier rulings, the Commissioner's statutory authority to issue new rulings retroactively, and the manner in which the Commissioner exercised his authority in this case.

A. In considering the nature of the earlier exemption rulings issued in 1934 and 1938, it is important to note that only Congress—and not the Commissioner—can relieve organizations of the obligation to pay taxes and to file tax returns. The Commissioner's function is limited to obtaining pertinent data and endeavoring to satisfy himself that taxpayers claiming such privileges are entitled to them. It was in the performance of that function that the Commissioner promulgated Regulations requiring the submission of data and issued the 1934 and 1938 rulings involved in this case. The Regulations did no more than specify what showing would be required to convince the Commissioner that the particular statutory provisions invoked by taxpayer applied. In 1935, the Board of Tax Appeals so construed these Regulations and the Commissioner published his ac-

quiescence in that decision. The 1934 and 1938 rulings, issued in accordance with these Regulations, did no more than advise taxpayer that the Commissioner concurred in its opinion that the applicable legislation excused it from paying taxes and filing tax returns. Noteworthy, too, is the nature of the error involved in these earlier rulings. The error was not in finding the facts or evaluating them; it was rather a pure error of law—an erroneous construction of the statute. The nature of that error is significant in that it resulted in the Commissioner's failure to assess and collect taxes imposed by Congress in accordance with the statutory mandate. When the existence of that error in earlier rulings was ascertained, the Commissioner was under an immediate duty to issue a new ruling to correct it.

B. Not only do various provisions of the Internal Revenue Code of 1939 clearly contemplate that incumbents of the office of Commissioner may make successive determinations of particular tax liabilities, but Section 3791 (b) expressly entrusts to executive discretion determination of the extent to which new rulings will be given retroactive effect.

C. And, not only did the taxpayer fail to prove that the Commissioner abused his discretion in making his 1945 ruling retroactive to 1943, the record establishes exactly the contrary. Thus, the principles of the 1945 ruling involved here had been announced in the general ruling published in 1943. That published ruling, which also revoked or recommended revocation of prior published exemption rulings in favor of local automobile clubs, was directed to the national organi-

zation of which taxpayer was a substantial dues-paying member and on whose board of directors taxpayer was represented. In reconsidering and revoking the many unpublished rulings in favor of other local automobile clubs, the Commissioner selected 1943 as the starting point for taxation of all of these clubs. Accordingly, all taxpayers—whether the previous exemption rulings which they had obtained were published or unpublished—were treated alike and the Commissioner's action clearly was not arbitrary.

Nor could taxpayer's failure to file tax returns for 1943 and 1944 possibly affect the Commissioner's power to revoke the prior exemption rulings and to direct taxpayer to file tax returns for those years. Thus, when the Commissioner in July 1945 revoked the earlier, erroneous rulings and directed taxpayer to file tax returns for 1943 and 1944, he could quite properly have then assessed deficiencies for 1943 and 1944, even if taxpayer had previously filed returns for those years.

II

The second issue, which also concerns only the years 1943 and 1944, involves taxpayer's alternative contention that, even if the action taken by the Commissioner in July 1945 was proper, assessment of the deficiencies for the years 1943 and 1944 became barred by the statute of limitations before the Commissioner mailed his deficiency notice. Under the provisions of Section 275 (a) of the Internal Revenue Code of 1939, however, the three-year statute of limitation starts to run only upon the filing of a tax return for the

particular year involved. Under the provisions of Section 276 (b), the time for assessing deficiencies may, before the expiration of the period, be extended and re-extended by agreement. Here tax returns for 1943 and 1944 were filed on October 22, 1945. Within three years thereafter, the period was extended by agreement. Within the extended period, the time was re-extended by a second agreement. Within the re-extended period, the deficiency notice was mailed. Accordingly, assessment of the deficiencies for 1943 and 1944 was not barred by the statute of limitations unless, as taxpayer contends, either the statute of limitations started to run before the filing of tax returns or certain information returns required to be filed by tax-exempt organizations constituted tax returns.

A. Taxpayer argues that the statute of limitations started to run prior to the time when tax returns were actually filed either (a) because it was not under a duty to file such returns or (b) because it was prevented from performing that duty by the Commissioner. This argument is based on two mistaken assumptions. First, it is erroneously assumed that the Commissioner could and did relieve taxpayer of the duty of filing tax returns. Second, it is mistakenly assumed that taxpayer was ready and willing to file tax returns before October 22, 1945, and that the Commissioner either deprived it of the opportunity or prevented it from doing so. Actually, however, the most that can be said for taxpayer is that its failure to file returns prior to July 1945 was due to a mutual mistake of law.

B. Assuming *arguendo* that the statute of limitation did not start to run before the filing of tax returns, taxpayer argues that the information returns which tax-exempt organizations were required to file should be held to constitute such tax returns. This argument ignores the purpose of having the statute of limitations start to run upon the filing of a tax return and misconceives the nature of the information return (Form 990). Under our self-assessment system, each taxpayer keeps his own records and from those records prepares and submits, on the form prescribed for the particular tax involved, the initial computation of his tax liability together with the required data. Deficiency assessments by the Commissioner are chiefly of a supplemental nature, designed to correct errors in the initial computations. Until the required data, with the initial computation, is submitted, the Commissioner is in no position to determine whether a deficiency assessment is necessary. Accordingly, in placing limitations on the period within which the Commissioner may assess deficiencies, it was only natural that Congress should provide that this period would begin only upon the filing of a return containing the data required for computation of the particular tax liability. The returns which taxpayer filed on October 22, 1945, were such returns. On the other hand, the information returns, which Congress required tax-exempt organizations to file, were designed for an entirely different purpose and did not require much of the data necessary for computation of the particular tax liabilities here involved. Those returns could not, therefore, be properly held

to constitute tax returns for the purpose of starting the running of the statute of limitations. Finally, the fact that Congress subsequently enacted special legislation under which such information returns would start the running of the statute of limitations in certain circumstances unlike those in the case at bar is further evidence that Congress did not intend such returns to be generally effective for that purpose.

III

The third issue, which relates to all five of the taxable years involved, concerns the time when taxpayer, an accrual basis taxpayer, should have included in gross income the dues received from members. Since taxpayer's right to receive these dues became fixed in the same years in which they were received, the accrual method of accounting requires inclusion of them in gross income for those years. More important here, however, than the particular accounting method chosen is the statutory requirement that income be computed for tax purposes on an annual rather than a transactional basis. As a corollary to this rule of annual accounting, the principle has become well established that, where an item of gross income is received under a claim of right and without restriction as to its disposition, inclusion of that item in a taxpayer's gross income cannot be deferred beyond the year of receipt, regardless of whether the taxpayer uses the cash or the accrual method of accounting. Here, the membership dues received by taxpayer involved no sale of property, but rather represented payments in advance for such serv-

ices as members might wish to receive in the ensuing twelve months. It is immaterial that taxpayer might later incur expenses in rendering services to members who had paid their dues in a previous year. Under well-settled principles, therefore, the membership dues received by taxpayer under a claim of right and without restriction of any kind were required to be included in its gross income for the years in which such dues were received. As shown by recent experience in connection with the 1954 Code, any change in these well-settled principles should be left to Congress, which now has the matter under study.

ARGUMENT

I

A CORRECT RULING THAT AUTOMOBILE CLUBS WERE NOT TAX-EXEMPT AS SOCIAL CLUBS HAVING BEEN PUBLISHED IN 1943, THE COMMISSIONER IN 1945 PROPERLY REVOKED PRIOR ERRONEOUS RULINGS IN FAVOR OF TAXPAYER AND DIRECTED IT TO FILE TAX RETURNS FOR 1943 AND 1944

This issue [8] relates to 1943 and 1944, the first two of the five taxable years here involved. At issue is the propriety of the Commissioner's action on July 16, 1945, when, in accordance with the published 1943 ruling that automobile clubs were not tax-exempt as social clubs, he (1) advised taxpayer of his determination that it was not tax-exempt, (2) revoked prior inconsistent rulings in favor of taxpayer, and (3)

[8] Issue I in the findings of fact and opinion of the Tax Court and in the opinion of the Court of Appeals, but Issue II in taxpayer's brief before this Court.

directed taxpayer to file tax returns (as distinguished from mere information returns) for 1943 and 1944.

The issue has been considerably narrowed by taxpayer's concession that it was not tax-exempt for 1945 and subsequent years (Br. 15). This concession in effect admits the correctness of the Commissioner's July 16, 1945, ruling (R. 67) that

> you are not a club "organized and operated exclusively for pleasure, recreation and other nonprofitable purposes", within the meaning of section 101 (9) of the Internal Revenue Code or the corresponding sections of prior revenue acts, and, therefore, are not entitled to exemption under those sections.

From this concession, compelled by the decided cases,[a] it necessarily follows (1) that taxpayer, whose purposes and activities remained substantially the same, was no more a tax-exempt corporation, within the meaning of Section 101 (9) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 69), in 1943 and 1944 then it was in 1945, 1946, and 1947; (2) that the similar ruling published in 1943 was correct; and (3) that the prior rulings in taxpayer's favor were erroneous.

It remains to be decided whether in July 1945 the Commissioner could properly revoke these earlier erroneous rulings and require payment of taxes for

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[a] *Chattanooga Auto. Club* v. *Commissioner*, 182 F. 2d 551 (C. A. 6th); *Warren Automobile Club* v. *Commissioner*, 182 F. 2d 551 (C. A. 6th); *Keystone Automobile Club* v. *Commissioner*, 181 F. 2d 402 (C. A. 3d); *Smyth* v. *California State Automobile Ass'n.*, 175 F. 2d 752 (C. A. 9th), certiorari denied, 338 U. S. 905; *Automobile Club of St. Paul* v. *Commissioner*, 12 T. C. 1152.

See also Treasury Regulations 111: 29-101 (9)-1 (Appendix, *infra*, pp. 75-76).

1943 and 1944. In discussing this question, we shall consider: first, the nature of the earlier rulings; second, the Commissioner's statutory authority to issue new rulings with retroactive application; and third, the manner in which the Commissioner exercised his statutory authority in this case.

A. THE PRIOR ERRONEOUS RULINGS MERELY ADVISED TAXPAYER THAT THE COMMISSIONER CONCURRED IN ITS CLAIM OF EXEMPTION.

In considering the nature of the earlier rulings issued in 1934 and 1938, it should be noted at the outset that Congress has never empowered the Commissioner to confer upon corporations a tax-exempt status or to excuse them from filing tax returns. Nor has Congress established broad standards with respect to these matters, leaving it to the Commissioner to prescribe in partcular the conditions required to meet those standards or to determine conclusively whether such standards have been met in a particular case. Rather, Congress itself, by Section 101 of the Internal Revenue Code of 1939 and corresponding sections of earlier revenue acts,[7] has specified the conditions under which organizations are to enjoy a tax-exempt status. And, in Section 52 of the 1939 Code (Appendix, *infra*, pp. 67–68) and corresponding sections of

[7] Sec. 101, Revenue Act of 1938, c. 289, 52 Stat. 447, 480; Sec. 101, Revenue Act of 1936, c. 690, 49 Stat. 1648, 1673; Sec. 101, Revenue Act of 1934, c. 277, 48 Stat. 680, 700; Sec. 103, Revenue Act of 1932, c. 209, 47 Stat. 169, 193; Sec. 103, Revenue Act of 1928, c. 852, 45 Stat. 791, 812; Sec. 231, Revenue Act of 1926, c. 27, 44 Stat. 9, 39; Sec. 231, Revenue Act of 1924, c. 234, 43 Stat. 253, 282; Sec. 231, Revenue Act of 1921, c. 136, 42 Stat. 227, 253; Sec. 231, Revenue Act of 1918, c. 18, 40 Stat. 1057, 1076; Sec. 11, Revenue Act of 1916, c. 463, 39 Stat. 756, 766.

earlier revenue acts,[8] Congress has required tax returns to be filed only by corporations "subject to taxation under this chapter." It is clear, therefore, that whether a corporation is or is not tax-exempt, or does or does not have a duty to file tax returns for any particular year, is not governed by the ruling made by the Commissioner. See *Southern Maryland Agricultural Fair Assn.* v. *Commissioner,* 40 B. T. A. 549.

It does not follow, of course, that the Commissioner, in view of his statutory duty to assess taxes due,[9] has no obligation to seek sufficient information to satisfy himself that the applicable legislation confers a tax-exempt status and relief from filing tax returns upon any taxpayers claiming such privileges. In the performance of that function, the Commissioner promulgated Regulations requiring the submission of relevant material concerning claimed tax exemptions.[10] These Regulations[11] did no more than provide what kind of

[8] Sec. 52, Revenue Act of 1938, c. 289, 52 Stat. 447, 476; Sec. 52, Revenue Act of 1936, c. 690, 49 Stat. 1648, 1670; Sec. 52, Revenue Act of 1934, c. 277, 48 Stat. 680, 697; Sec. 52, Revenue Act of 1932, c. 209, 47 Stat. 169, 188; Sec. 52, Revenue Act of 1928, c. 852, 45 Stat. 791, 808; Sec. 239, Revenue Act of 1926, c. 27, 44 Stat. 9, 45; Sec. 239, Revenue Act of 1924, c. 234, 43 Stat. 253, 287; Sec. 239, Revenue Act of 1921, c. 136, 42 Stat. 227, 259; Sec. 239, Revenue Act of 1918, c. 18, 40 Stat. 1057, 1081; Sec. 13, Revenue Act of 1916, c. 463, 39 Stat. 756, 770.

[9] Section 3640 of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Sec. 3640).

[10] Section 62 of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Sec. 62) confers authority on the Commissioner to make all necessary rules and regulations.

[11] Sections 29.101-1 and 29.101-2, Treasury Regulations 111 (Appendix, *infra*, pp. 70-75). Prior to the enactment of the Revenue Act of 1943, c. 63, 58 Stat. 21, these Regulations contained the following provision (Section 29.101-1):

showing would be required to convince the Commissioner that the particular statutory provisions invoked by taxpayer were applicable. The Regulations did not, and could not, mean that a taxpayer who had obtained a favorable ruling from the Commissioner under the Regulations was forever excused from paying taxes and from filing the returns for past years, even though it later appeared that the Commissioner's ruling was based on an erroneous construction of the statute. Conversely, the Regulations did not, and could not, mean that a taxpayer who had failed to comply with the Regulations was barred from any

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"When an organization (other than a mutual insurance company) has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, * * * except that every organization exempt or claiming exemption under section 101 * * * (9) * * * shall file annually returns of information on Form 990 with the collector for the district in which is located the principal place of business or principal office of the organization * * *."

Section 117 of the Revenue Act of 1943, *supra* (which added Section 54 (f) of the Internal Revenue Code of 1939, Appendix, *infra*, pp. 68–69), not only made the filing of annual information returns by tax-exempt organizations a statutory duty but also required such organizations to "make such other returns" as might from time to time be prescribed. With respect to proof of exemption on or after January 1, 1943, Section 29.101–2 of the Regulations, as added by T. D. 5381, 1944 Cum. Bull. 188, 192, to conform with the Revenue Act of 1943, eliminated the above-quoted regulatory provision and added the following:

"Every organization which has established its right to exemption from tax whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the Commissioner for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of section 54 (f) and this section."

exemption or other privilege conferred by the statute. Thus, in *Savings Feature of Relief Dept. of B. & O. R. R. Co.* v. *Commissioner,* 32 B. T. A. 295, the Board of Tax Appeals, in holding a banking corporation to be tax-exempt although it had not complied with the Regulations, stated (pp. 305–306):

> Authority for the provisions of the regulations relating to "Proof of exemption" must be found in the general authority granted in each revenue act to the Commissioner to make all needful rules and regulations for the enforcement of the provisions of the act. The revenue acts did not confine the exemption to those banks which might file proof of exemption with the Commissioner. * * * The Commissioner, in effect, says in these articles, that each organization claiming exemption, if it wants him to agree that it is exempt, must file proof of its exemption with him. The penalty for failure to comply seems to be that the Commissioner, if he has doubts of the exempt character of any organization, may assess the tax and put that organization to the trouble of proving elsewhere its right to exemption.

The Commissioner published his acquiescence in this decision in 1935, XIV-1 Cum. Bull. 18.[12] See also

[12] The instant record illustrates that in practice Internal Revenue Service also adhered to this interpretation of the Regulations. Accordingly, where, as here, an organization, believed to be tax-exempt, failed to comply with the Regulations for several years and subsequently requested and received a favorable exemption ruling, no attempt was made to penalize it for not having complied with the Regulations in earlier years, and it was treated as tax-exempt from the start rather than merely from the time it complied with the Regulations and obtained the favorable ruling.

Langstaff v. *Lucas,* 9 F. 2d 691, 693 (W. D. Ky.), affirmed *per curiam,* 13 F. 2d 1022 (C. A. 6th), certiorari denied, 273 U. S. 721.

The 1934 and 1938 rulings, issued in accordance with these Regulations, did no more than advise taxpayer that in the Commissioner's opinion, on the basis of the data submitted, the particular statutory provisions invoked by taxpayer did apply, and that, barring a change of circumstances, the Commissioner would ~~not~~ require additional data to convince him. The 1934 and 1938 rulings, then, were merely interpretive rulings expressing the Commissioner's concurrence in taxpayer's opinion that the applicable legislation excused it from paying taxes or filing tax returns. Plainly, if the rulings had been adverse to taxpayer, nothing would have prevented taxpayer from challenging the Commissioner's position in the courts.

Noteworthy, too, is the nature of the error involved in these earlier rulings. The Commissioner's error was not in finding the facts or in evaluating them. It was rather a pure error of law arising from an erroneous construction of the statute.[13] Thus, as both the 1943 and 1945 rulings show (see *supra,* pp. 7–10), the error was due to the Commissioner's misinterpretation of the terms "club" and "other non-

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[13] This erroneous statutory construction was not embodied in any generally applicable regulation so that it could be said to have received congressional approval upon re-enactment of the statute without substantial change. The situation here, therefore, is not like that in *Helvering* v. *Reynolds Co.*, 306 U. S. 110, upon which taxpayer here relies. (Br. 62–63.) See *Eastman Kodak Co.* v. *United States*, 48 F. Supp. 357 (C. Cls.).

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profitable purposes," as those terms are used in Section 101 (9) of the 1939 Code and corresponding sections of earlier revenue acts.[14] The nature of this error is significant in that it resulted in the Commissioner's failure to assess and collect taxes imposed by Congress in accordance with his statutory mandate.[15] Having ascertained this error in the earlier rulings, it was incumbent upon the Commissioner to issue a new ruling to correct it. And, in the absence of some statutory prohibition, it is difficult to see why the Commissioner's statutory duty did not require him to apply his corrective ruling retroactively, at least to 1943 when the Commissioner's new construction of the statute was publicly announced.[16] As we shall show (*infra*, pp. 29–32), far from there being

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[14] These were also the grounds upon which the court decisions, cited in fn. 6 *supra*, p. 22, were based.

[15] Taxpayer relies (Br. 53–58) on cases such as *H. S. D. Co.* v. *Kavanagh*, 191 F. 2d 831 (C. A. 6th); *Woodworth* v. *Kales*, 26 F. 2d 178 (C. A. 6th); and *Lesavoy Foundation* v. *Commissioner* 238 F. 2d 589 (C. A. 3d). But the correctness of those cases need not be considered here, since they hold only that the Commissioner must abide by earlier rulings in the exceptional circumstances involved there. So far as relevant here, they expressly recognize that the Commissioner necessarily has authority retroactively to revoke earlier rulings which either involved errors of law or are tainted by fraud. Among the other cases holding that the Commissioner may properly correct his own or his predecessor's mistakes in the computation of particular tax liabilities are: *Burnet* v. *Porter*, 283 U. S. 230; *Sweets Co. of America* v. *Commissioner*, 40 F. 2d 436 (C. A. 2d); *McIlhenny* v. *Commissioner*, 39 F. 2d 356 (C. A. 3d); *Knapp-Monarch Co.* v. *Commissioner*, 139 F. 2d 863 (C. A. 8th); and *Commissioner* v. *Newport Industries*, 121 F. 2d 655 (C. A. 7th).

[16] See Magill, *Finality of Revenue Determinations*, 28 Col. L. Rev. 563.

any statutory prohibition, Congress has recognized that there might be successive determinations of a particular tax liability by those occupying the office of Commissioner, and, moreover, has expressly granted the Commissioner statutory authority for issuing new rulings with retroactive effect. As we shall also show (*infra*, pp. 33–37), the Commissioner properly exercised his statutory authority in this case.

B. UNDER SECTION 3791 (b) OF THE INTERNAL REVENUE CODE OF 1939, THE COMMISSIONER HAD DISCRETION TO APPLY CORRECTIVE RULINGS RETROACTIVELY

In enacting the various provisions of the 1939 Code and prior revenue acts, Congress did not proceed on the assumption that every Commissioner would be infallible in his interpretation of the revenue laws. Rather, Congress was aware that errors were inevitable and that there would necessarily be successive determinations of particular tax liabilities, either by the same Commissioner or by successive Commissioners. Thus, for example, in enacting the provisions with respect to the finality of closing agreements, contained in Section 3760 of the 1939 Code (26 U. S. C. 1952 ed., Sec. 3760) and corresponding sections of prior revenue acts, Congress recognized that cases might be reopened but for the application of those provisions.[17] And the definition of a deficiency

[17] In recommending enactment of the Revenue Act of 1921, c. 136, 42 Stat. 227, the Senate Committee on Finance explained the closing agreement provisions contained in Section 1312 of that Act, as follows (S. Rep. No. 275, 67th Cong., 1st Sess., pp. 31–32; 1939-1 Cum. Bull. (Part 2) 181, 204):

"Under the present method of procedure a taxpayer never knows when he is through, as a tax case may be opened at any time because of a change in ruling by the Treasury Depart-

contained in Section 271 of the 1939 Code (26 U. S. C. 1952 ed., Sec. 271), as well as in corresponding sections of prior revenue acts, clearly presupposed the possibility of previous determinations of particular tax liabilities.[18]

Section 3791 (b) of the 1939 Code (Appendix, *infra*, p. 70) dispels any remaining doubt whether Congress intended to authorize the Commissioner (with the approval of the Secretary) to apply corrective rulings retroactively. That section provides:

> *Retroactivity of Regulations or Rulings.*—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

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ment. It is believed that this provision will tend to promote expedition in the handling of tax cases and certainly in tax adjustment."

[18] Section 271 (a) of the Internal Revenue Code of 1939, as amended by Section 14 (a) of the Individual Income Tax Act of 1944; c. 210, 58 Stat. 231, 245, provided:

"*In General.*—As used in this chapter in respect of a tax imposed by this chapter, 'deficiency' means the amount by which the tax imposed by this chapter exceeds the excess of—

"(1) the sum of (A) the amount shown as the tax by the taxpayer upon his return, if a return was made by the taxpayer and an amount was shown as the tax by the taxpayer thereon, plus (B) *the amounts previously assessed* (or collected without assessment) *as a deficiency*, over—

"(2) the amount of rebates, as defined in subsection (b) (2), made." (Emphasis added.)

In *Helvering* v. *Reynolds Co.*, 306 U. S. 110, this Court, in construing the corresponding section of the Revenue Act of 1928,[19] stated (p. 116):

> It is clear from this provision that Congress intended to give to the Treasury power to correct misinterpretations, inaccuracies, or omissions in the regulations *and thereby to affect cases in which the taxpayer's liability had not been finally determined,* unless, in the judgment of the Treasury, some good reason required that such alterations operate only prospectively. [Emphasis added.]

The provision involved in *Reynolds* related only to Treasury regulations and Treasury decisions, but the Revenue Act of 1934 (c. 277, 48 Stat. 680) broadened the Commissioner's authority under this provision to include rulings as well, and its language was incorporated without change in the Section 3791 (b) of the 1939 Code. Under the circumstances, to apply the quoted language in the *Reynolds* case to this situation it is clear from Section 3791 (b) that Congress intended to give the Treasury power to correct misrepresentations in rulings and thereby affect cases in which the taxpayer's liability had not been finally determined, unless in the judgment of

[19] Section 605 of the Revenue Act of 1928, c. 852, 45 Stat. 791, 874, provided:

"Section 1108 (a) of the Revenue Act of 1926 is amended to read as follows:

"'Sec. 1108 (a). (a) In case a regulation or Treasury decision relating to the internal-revenue laws is amended by a subsequent regulation or Treasury decision, made by the Secretary or by the Commissioner with the approval of the Secretary, such subsequent regulation or Treasury decision may, with the approval of the Secretary, be applied without retroactive effect.'"

the Treasury, some good reason required that such alterations operate only prospectively.[30]

In the case at bar, the Commissioner exercised this statutory authority in issuing his 1945 ruling which, in accordance with the published 1943 ruling, revoked the prior erroneous rulings in favor of taxpayer and required it to file tax returns for 1943 and 1944.

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[30] In recommending enactment of the provisions of the Revenue Act of 1934 which became Section 3791 (b) of the 1939 Code, H. Rep. No. 704, 73d Cong., 2d Sess., p. 38 (1939-1 Cum. Bull. (Part 2) 554, 583) stated:

"The amendment extends the right granted by existing law to the Treasury Department to give regulations and Treasury decisions amending prior regulations or Treasury decisions prospective effect only, by allowing the Secretary, or the Commissioner with the approval of the Secretary, to prescribe the exact extent to which any regulation or Treasury decision, whether or not it amends a prior regulation or Treasury decision, will be applied without retroactive effect. The amendment furthermore permits internal revenue rulings as well as regulations or Treasury decisions to be applied without retroactive effect. *Regulations, Treasury decisions, and rulings which are merely interpretative of the statute, will normally have a universal application*, but in some cases the application of regulations, Treasury decisions, and rulings to past transactions which have been closed by taxpayers in reliance upon existing practice, will work such inequitable results that it is believed desirable to lodge in the Treasury Department the power to avoid these results by applying certain regulations, Treasury decisions, and rulings with prospective effect only." (Emphasis added.)

S. Rep. No. 558, 73d Cong., 2d Sess., p. 48 (1939-1 Cum. Bull. (Part 2) 586, 623), is substantially the same. It is clear, therefore, that the purpose of Congress in enacting the provisions of 1939 Code Section 3791 (b) was not, as taxpayer contends (Br. 64), merely to prevent retroactivity rather than to confirm any right of the Commissioner to take retroactive action.

C. THE COMMISSIONER DID NOT ABUSE HIS DISCRETION IN THIS CASE

Not only did the taxpayer fail in its attempt to prove that the Commissioner acted arbitrarily or unfairly in exercising this statutory authority,[21] but the record establishes precisely the contrary.

The principles upon which the Commissioner's ruling of July 16, 1945, was based had been announced in G. C. M. 23688, namely, that Section 101 (9) of the 1939 Code conferred a tax-exempt status only on those organizations which were characterized by a commingling of members, one with another, in fellowship, and which were organized and operated exclusively for pleasure, recreation and other *similar* nonprofitable purposes. See Statement, *supra,* pp. 7–10. G. C. M. 23688, which ruled that the American Automobile Association was not tax-exempt and which revoked, or recommended revocation of, prior published rulings in favor of local automobile clubs, was published in the Internal Revenue Bulletin of July 11, 1943. Upon the publication of this ruling, it became necessary for the Commissioner to re-examine all of the cases in which local automobile clubs had previously obtained favorable *unpublished* rulings. And, in re-examining these cases, it was only fair that the Commissioner afford each club an opportunity to submit additional data in the light of G. C. M. 23688.[22] Because of the number of such organizations

[21] See *Austin Co.* v. *Commissioner*, 35 F. 2d 910 (C. A. 6th).

[22] By the Commissioner's letter of May 12, 1945, taxpayer was afforded such an opportunity (R. 59–60). Taxpayer appears to have overlooked this in arguing (Br. 47) that the Commissioner directed it to file tax returns for 1943 and 1944 without any further inquiry as to the facts.

involved, it became apparent that, while new rulings might be issued in many cases before the end of 1943, the processing of all of the cases would take considerably longer. Yet, in the Commissioner's view, fairness required that all of the clubs, whether the favorable rulings which they had previously obtained were published or unpublished, be treated alike, *i. e.*, that they be required to start paying taxes as of the same time. Therefore, since G. C. M. 23688 had been issued and published in 1943, 1943 was selected as the starting point for the taxation of all of these clubs, as the Tax Court found (R. 155–156).

The taxpayer, which of course had the burden of proof in the Tax Court, also failed to prove that it did not in 1943 have actual, as well as constructive, notice of the ruling with respect to the American Automobile Association published in that year as G. C. M. 23688. The record shows that taxpayer was a member of the American Automobile Association and that during the period from 1943 to 1947 it paid that organization dues varying in amounts from approximately $53,000 to approximately $65,000 per year. (Schedule K, Exs. 13, 15, 17, 19, 20; R. 20, 182, 183, 185, 187, 189.) Nor can it be disputed that taxpayer was represented on the board of directors of the American Automobile Association during this period. Taxpayer did not attempt to establish that the board of directors of the American Automobile Association or its members did not discuss such an important matter as G. C. M. 23688 and the revocation of the prior ruling as to that association's exemption from a tax. Nor did taxpayer

offer any evidence to show that the American Automobile Association did not call to the attention of its local club members the fact that G. C. M. 23688 also revoked, or recommended revocation of, prior published exemption rulings in favor of local clubs. If taxpayer did have notice of G. C. M. 23688—and there is nothing in the record to the contrary—the 1945 ruling cannot even be said to be retroactive except in a limited technical sense; for, as taxpayer was well aware, its organization was factually indistinguishable, for exemption purposes, from the organizations involved in G. C. M. 23688.

In any event, taxpayer is in no position to maintain that the Commissioner acted inequitably in July 1945 when, after further consideration, he revoked prior erroneous rulings in favor of taxpayer and directed it to file tax returns for 1943 and 1944. Taxpayer's case is certainly not one of hardship, for, while the deficiencies found by the Tax Court for the years 1943 and 1944 totalled $125,048 and $120,492, respectively (R. 181–182), taxpayer's balance sheets and tax returns show that it had an earned surplus and undivided profits at the beginning of 1943 of $920,193.84, at the beginning of 1944 of $1,046,230.85, and at the beginning of 1945 of $1,300,471.81 (Schedule L, Exs. 13, 15; R. 68B, 76, 89).[23]

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[23] Compare *Lesavoy Foundation* v. *Commissioner*, 238 F. 2d 589 (C. A. 3), where the court, in holding that the Commissioner under the particular circumstances presented there had abused his discretion in retroactively revoking an exemption ruling, pointed out that the Commissioner's assessment, if enforced, would wipe out the assets of the taxpayer in that case. The revo-

Taxpayer surely had no vested right in a wrong construction of the statute by the Commissioner. The measure by which taxes are imposed is that laid down in the statute, as correctly read and not as mistakenly interpreted by government officers. See *supra*, pp. 23–27. If, as seems clear, taxpayer could not have acquired the right to escape taxes or the right to fail to file tax returns by virtue of judicial decisions subsequently overruled, *a fortiori* it could not acquire such rights by virtue of Commissioners' opinions subsequently overruled.

Nor could the fact that taxpayer had not filed tax returns for 1943 and 1944 possibly have any effect upon the Commissioner's authority to revoke the prior exemption rulings and to direct taxpayer to file tax returns for those years at the time when the Commissioner took such action. Thus, when the Commissioner on July 16, 1945, revoked the earlier erroneous rulings and directed taxpayer to file tax returns for 1943 and 1944, he could quite properly have then assessed deficiencies for 1943 and 1944, even if taxpayer had previously filed tax returns for those years.[24]

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cation in the *Lesavoy* case, it may also be noted, was made retroactive five years, in contrast with the two years in this case. There was, moreover, in *Lesavoy* no prior published ruling (such as the 1943 ruling in this case) expressly rejecting the basis of the claimed exemption. On the basis of the differences between the two cases, the Third Circuit in *Lesavoy* distinguished the instant case. See note 15, *supra*.

[24] Under Section 53 of the Internal Revenue Code of 1939 (26 U. S. C. 1952 ed., Sec. 53), taxpayer's tax returns for 1943 and 1944 were due on March 15, 1944, and March 15, 1945, re-

Indeed, taxpayer is hardly in a position to invoke the "equities" of the situation. Having been mistakenly allowed to escape taxes and the filing of tax returns for the period from 1916 through 1942, taxpayer is now claiming that it should also be allowed these unwarranted privileges for 1943 and 1944. It is, moreover, seeking privileges not accorded to other automobile clubs. The Commissioner, on the other hand, seeks only uniform application of the revenue laws, and the payment of taxes actually imposed by Congress.

II

ASSESSMENT OF THE DEFICIENCIES FOR 1943 AND 1944 WAS NOT BARRED BY THE STATUTE OF LIMITATIONS

This issue,[25] which also relates only to the years 1943 and 1944, involves an alternative contention of taxpayer—namely, that assessment of any deficiencies for those years was barred by the statute of limitations before the Commissioner mailed his deficiency notice. (Br. 73–82.) Consideration of this contention requires a review of the sequence of events in the light of the applicable statutory provisions.

Section 275 (a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 69) provides that taxes, such as are here involved, "shall be assessed *within three years after the return was filed.*" (Emphasis

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spectively. Under Section 275 (a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 69), assessment of any deficiency could be made within three years after such returns were filed.

[25] Issue II in the findings of fact and opinion of the Tax Court and in the opinion of the Court of Appeals, but Issue III in taxpayer's brief before this Court.

added.) Section 276 (b) (Appendix, *infra,* p. 70) authorizes an extension of the time prescribed by Section 275 if, before the expiration of that time, both the Commissioner and the taxpayer consent in writing to assessment of a tax after such time. In that event, "the tax may be assessed at any time prior to the expiration of the period agreed upon" and, moreover, the agreed period may be further extended by subsequent written agreements made before expiration of the period previously agreed upon. Section 276 (a) (Appendix, *infra,* pp. 69–70) provides that in the case "of a failure to file a return the tax may be assessed * * * at any time."

Here, after receiving the Commissioner's ruling of July 16, 1945, the taxpayer, under protest, filed income and excess profits tax returns for 1943 and 1944 on October 22, 1945. Within three years after October 22, 1945, namely, on August 25, 1948, the parties entered into a written agreement allowing assessment on or before June 30, 1949. Before June 30, 1949, namely, on May 23, 1949, the parties entered into a further agreement providing that the taxes could be assessed on or before June 30, 1950. (Exs. C and D, R. 108, 112; R. 156–157.) Before June 30, 1950, namely, on February 20, 1950, the notice of deficiency forming the basis of this proceeding was mailed to the taxpayer.[26] Prior to October 22, 1945,

[26] After the mailing of the notice of deficiency and the filing of a petition for redetermination in the Tax Court, the running of the statute of limitations is suspended until after the decision of the Tax Court has become final. Sections 272 (a) and 277 of the Internal Revenue Code of 1939 (26 U. S. C. 1952, ed., Secs. 272 (a) and 277).

when taxpayer filed its tax returns for 1943 and 1944, taxpayer had merely filed annual information returns on Form 990 (*supra,* p. 10).

From the foregoing, it is clear that assessment of the deficiencies for 1943 and 1944 was not barred by the statute of limitations if the agreement of August 25, 1948, was timely. And the agreement was timely unless, as taxpayer contends (Br. 73–81), either (a) the statute started to run prior to the actual filing of tax returns on October 22, 1945, or (b) the annual information returns on Form 990 constituted tax returns for purposes of starting the statute running.

A. THE STATUTE OF LIMITATIONS DID NOT START TO RUN BEFORE THE TAX RETURNS FOR 1943 AND 1944 WERE FILED

Citing *Balkan Nat. Ins. Co.* v. *Commissioner,* 101 F. 2d 75 (C. A. 2d), and *Stockstrom* v. *Commissioner,* 190 F. 2d 283 (C. A. D. C.), both decided by divided courts, taxpayer in effect argues that it would be inequitable to allow the Commissioner to rely upon the fact that no tax returns were filed for 1943 and 1944 prior to October 22, 1945. According to taxpayer, either it was under no duty to file such returns before that time or it was prevented from performing that duty by the Commissioner. (Br. 73–77.) This argument is grounded upon two erroneous assumptions.

First, it is assumed that the Commissioner could relieve taxpayer of any duty to file tax returns. But, as shown in Point I of our argument (*supra,* pp. 23–27), the Commissioner had no such power. Under the applicable statutory provisions, taxpayer conced-

edly was subject to taxation and was required to file tax returns. Nor was taxpayer's duty affected by the Commissioner's erroneous interpretation of the statutory provisions,"[27] for, as stated in *Schafer* v. *Helvering*, 83 F. 2d 317, 320 (C. A. D. C.), affirmed, 299 U. S. 171: "Whoever deals with the government does so with notice that no agent can, by neglect or acquiescence, commit it to an erroneous interpretation of the law." See also the decision, directly in point, of the Board of Tax Appeals in *Southern Maryland Agricultural Fair Assn.* v. *Commissioner*, 40 B. T. A. 549, 553, holding that "the [Commissioner's] erroneous ruling did not relieve the petitioner from filing the returns and paying the taxes as the statute provided, and it did not start the running of any statutory period of limitation."

Second, it is assumed that the taxpayer was ready and willing to file tax returns before October 22, 1945, and that the Commisssioner either deprived it of the opportunity or prevented it from doing so. Such is clearly not the case. The record does not indicate either that taxpayer was willing to file tax returns when such returns were due or that it would have filed them even if it had not obtained favorable rulings

[27] It is perhaps noteworthy in this connection that the Commissioner's erroneous view of the law did not remain unchanged until October 22, 1945, when taxpayer actually filed tax returns for 1943 and 1944. Rather, G. C. M. 23688, *supra*, which revoked, or recommended revocation of, prior published rulings in favor of automobile clubs, was published on July 11, 1943, and the ruling of July 16, 1945, which revoked prior unpublished rulings in favor of taxpayer and directed it to file tax returns for 1943 and 1944, was issued more than three months before taxpayer actually filed its tax returns.

from the Commissioner. Rather, the record shows that the taxpayer was the moving party in the matter, that in 1934 and during 1937 and 1938 it repeatedly claimed an exempt status under the statute, and that it prepared and submitted evidence to the Commissioner in order to induce him (as it did) to issue the rulings in its favor.[28] The Government had not seized taxpayer's books and records or in any other way interfered with the filing of tax returns.

The most that can be said for taxpayer is that its initial failure to file was due to a mutual mistake of law. And, while the nature of that error may have been such as to excuse taxpayer from any penalty for late filing (since failure to file would not be due to willful neglect), surely the mere fact that the Commissioner at first shared taxpayer's mistaken view of the law should not affect the normal operation of the statute of limitations on assessment of deficiencies. Moreover, on July 16, 1945, long before the expiration of the three-year periods after March 15, 1944, and March 15, 1945, respectively, the Commissioner expressed his view in writing to the taxpayer that it was subject to taxation and was required to file tax returns for 1943 and 1944. There plainly is no basis

[28] Taxpayer's claim that it was tax-exempt and accordingly not required to file tax returns not only preceded (instead of resulted from) the Commissioner's erroneous rulings in its favor but also survived his July 1945 ruling that it was subject to taxation and required to file tax returns for 1943 and 1944. Thus, when taxpayer actually filed tax returns for those years it filed them under protest, and, until this case came on for hearing in the Tax Court, taxpayer contended that it was tax-exempt not only for 1943 and 1944, but also for the subsequent years in issue.

for any suggestion that taxpayer was lulled into believing that the Commissioner had dropped his claims for those years or that taxpayer was prejudiced in any other manner. On the contrary, it must be assumed that the parties, in signing the agreements of August 1948 and May 1949 extending the period within which the taxes might be assessed, intended an effective, not a futile, act. The purpose of the statute of limitations would not be effectuated by resort to the fiction of treating the taxpayer's tax returns as if they had been filed before their actual filing.

The Tax Court in its opinion correctly distinguished the *Balkan Nat. Ins. Co.* and the *Stockstrom* cases, upon which the taxpayer relies. In the *Balkan Nat. Ins. Co.* case (C. A. 2), *supra,* the court held (p. 78) that the Government, by seizing all of the taxpayer's records through the Alien Property Custodian and by denying taxpayer access to such records, had made it impossible for taxpayer to prepare and file a return of its 1918 income. In addition, the deficiency notice was not mailed to taxpayer in Bulgaria until 1934. Hence, under those circumstances, which obviously differ greatly from the facts here, the Court held that Section 276 (a) (Appendix, *infra,* pp. 69–70) did not apply since that taxpayer's failure to file a return was due to an impossibility created by the Government.

In the *Stockstrom* case (C. A. D. C.), *supra,* where gifts for 1938 were involved and the notice of deficiency was not sent until 1948, the court concluded that the purpose of the filing requirement was fulfilled although no return had been filed, since in 1941

the Government possessed all pertinent facts and the limitation period commenced to run at that time. Here, on the other hand, on March 15, 1944, and March 15, 1945, taxpayer was in full possession of its books and records and the Government was not in possession of sufficient information to enable it to file a return for the taxpayer. Besides, as already pointed out, long before the period of limitations had expired, if computed from those dates, namely, on July 16, 1945, the Commissioner expressly directed taxpayer to file returns. Like the facts of the *Balkan Nat. Ins. Co.* case, the facts of the *Stockstrom* case differ radically from those of the instant case.

B. THE ANNUAL INFORMATION RETURNS ON FORM 990 DID NOT CONSTITUTE TAX RETURNS

Assuming *arguendo* that the statute of limitations did not start to run before the actual filing of tax returns for 1943 and 1944 on October 22, 1945, taxpayer alternatively argues that the Forms 990 filed on August 12, 1944, and May 17, 1945, should be held to constitute such returns. (Br. 77–81.) This argument ignores the relationship between the filing of tax returns and the assessment of deficiencies, and misconceives the nature of the annual information returns on Form 990.

For the collection of its income and excess profits taxes, the United States relies largely upon a system of self-assessment. See *Commissioner* v. *Lane-Wells Co.,* 321 U. S. 219, 223. Thus, each taxpayer keeps his or its own records, and from those records prepares and submits, on the form prescribed for the

particular tax involved, the data required for computation and the initial computation of his (or its) tax liability. Under the circumstances, deficiency assessments by the Commissioner are chiefly of a supplemental nature, designed to correct errors in the initial computations. Until the taxpayer has submitted the necessary data, with the initial computation, the Commissioner is in no position to determine whether there should be a deficiency assessment. Accordingly, in directing in Section 275 (a) that any deficiency in income (and excess profits)[29] tax should be assessed within three years "after the return was filed," Congress quite clearly meant the return containing the data required for computation of the particular tax liability.

This conclusion appears to be implicit in *Commissioner* v. *Lane-Wells Co., supra.* There, the taxpayer, a personal holding company, had, with respect to the income tax, filed a return for each year on Form 1120, but had, with respect to the surtax imposed on personal holding companies, failed to file a separate return on Form 1120H as required by Treasury Regulations. Distinguishing its prior decision in *Germantown Trust Co.* v. *Commissioner,* 309 U. S. 304, on which taxpayer in the instant case relies (Br. 78–79),[30] this Court stated (321 U. S. at 222–224):

[29] Section 275 (a) refers specifically to income taxes, but by Section 729 (26 U. S. C. 1952 ed., Sec. 729) its provisions were also made applicable to the excess profits tax.

[30] As this Court recognized in its *Lane-Wells* opinion (see excerpt quoted *infra* in the text), the *Germantown* case held no more than that a taxpayer could not be said to have filed no tax return where he submitted all of the data necessary

The taxpayer has not complied with this regulation. It says, however, that its regular corporation income tax return must be taken as an equivalent to the separate return, under our [*Germantown*] decision * * * both for starting the period of limitation and for avoiding the penalty. The taxpayer in the *Germantown* case filed a return on a wrong form. The return contained, however, "all of the data from which a tax could be computed and assessed although it did not purport to state any amount due as tax," and the Court said, "this defect falls short of rendering it no return whatever." 309 U. S. at 308, 310. There the only liability involved was for a Title I income tax, and the return was addressed to that liability, as to which the court held that it set the statute of limitations running. Here the taxpayer is under liabilities for two taxes and under an obligation to file two returns, and it says that one return addressed to but one of the liabilities answers the purpose of both.

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for computation of the particular tax liability but submitted it on the wrong form. In that case, the trustee of a fund filed a fiduciary return which disclosed all the data from which the tax, treated as one imposed upon a corporation, could be computed, and attached a list of the beneficiaries of the fund and their shares of the income. These beneficiaries included in their individual returns their shares of the income. The Commissioner determined that the fund should be taxed as a corporation and, from the fiduciary return, prepared a substitute corporation return on Form 1120 and gave notice of a consequent tax deficiency. The Court held (p. 310): "It cannot be said that the petitioner, whether treated as a corporation or not, made no return of the tax imposed by the statute. Its return may have been incomplete in that it failed to compute a tax, but this defect falls short of rendering it no return whatever."

> Congress has given discretion to the Commissioner to prescribe by regulation forms of returns and has made it the duty of the taxpayer to comply. It thus implements the system of self-assessment which is so largely the basis of our American scheme of income taxation. *The purpose is not alone to get tax information in some form but also to get it with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns may be readily accomplished.* For such purposes the regulation requiring two separate returns for these taxes was a reasonable and valid one and the finding of the Board of Tax Appeals that the taxpayer is in default is correct. [Emphasis added.]

Accordingly, it was held that the filing of the ordinary income-tax returns did not start the statute of limitations against the surtax.

In this case, we are concerned with corporate income and excess profits tax liabilities. By Section 29.52–1 of Treasury Regulation 111 (Appendix, *infra*, p. 70), the Commissioner prescribed the form (Form 1120) upon which corporations should submit returns with respect to their income tax liability. By Section 35.729–1 of Treasury Regulations 112, the Commissioner also prescribed the form (Form 1121) upon which corporations should submit returns with respect to their excess profits tax liability. It is not disputed that those forms called for the data required for computation of the particular tax liabilities involved, and that they called for its submission "with such uniformity, completeness, and arrangement that the physical task of handling and verifying returns

may be readily accomplished." It follows, therefore, that the returns which taxpayer filed on those forms on October 22, 1945, constituted the tax returns which started the running of the statute of limitations on assessment of income and excess profits tax deficiencies.

The returns which taxpayer filed on Form 990 [31] were special annual returns of information which many tax-exempt organizations were required to file pursuant to Section 54 (f) of the 1939 Code (Appendix, *infra*, pp. 68–69) and Section 29.101-2 of Treasury Regulations 111, as added by T. D. 5381, 1944 Cum. Bull. 188, 190–192 (Appendix, *infra*, pp. 72–75). They were not intended to, and did not furnish the data required for computation of income or excess profits tax liabilities. Like the ordinary income tax returns in the *Lane-Wells* case, *supra*, taxpayer's Form 990 returns were insufficient to start the statute of limitations running.

Section 54 (f) was added to the 1939 Code by Section 117 (a) of the Revenue Act of 1943, c. 63, 58 Stat 21, 36. Its purpose in requiring the novel information return, as explained in the committee reports, was not to obtain the data necessary to compute income and excess profits tax liabilities, but rather to obtain information with a view to determining whether legislation should be framed subjecting to taxation certain tax-exempt corporations which were competing with other corporations which did not enjoy similar

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[31] Taxpayer's Form 990 returns were filed on August 12, 1944, and May 17, 1945.

privileges.[32] H. Rept. No. 871, 78th Cong., 1st Sess., pp. 24–25 (1944 Cum. Bull. 901, 920); S. Rep. No. 627, 78th Cong., 1st Sess., p. 21 (1944 Cum. Bull. 973, 990).

Not only did taxpayer's returns on Form 990 fail to supply the data necessary for computation of the particular tax liabilities involved with the necessary "uniformity, completeness, and arrangement," but they did not, as the Tax Court found (R. 156), furnish certain essential data at all. Thus, examination of the Forms 990 filed by taxpayer shows that items of income and disbursement are given only in summary fashion (Ex. 21; R. 95–105). In contrast, the Forms 1120 and 1121 eventually filed by taxpayer for the years 1943 and 1944 (Exs. 13, 14, 15, 16; R. 70–94) contain, as required by the Commissioner, the appropriate information in complete detail.[33]

Finally, in enacting subsequent legislation, Congress demonstrated its awareness that the filing of Form 990 returns was, in the absence of special legislation to the contrary, insufficient to start the statute of limitations

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[32] In view of this congressional purpose, there is no merit in taxpayer's apparent suggestion (Br. 81) that Form 990 should have been so drafted as to obtain the data necessary for computation of income and excess profits tax liabilities.

[33] For example, taxpayer's Form 990 returns failed to show claims for depreciation deductions or their details as required by Item 25 (R. 71, 84) and Schedule J (R. 86) of Forms 1120 and 1121. Similarly, income subject to excess profits tax constituted for the years in question an essential factor in the computation of both the income and excess profits tax (Item 38, R. 71; Item 8, R. 77; Item 39, R. 84; Item 8, R. 91), but the income subject to excess profits tax, in turn, depended in large part on the excess profits credit adjustment (R. 80–81, 93–94), with respect to which the returns on Form 990 afforded no information.

running. In Section 302 (b) of the Revenue Act of 1950 (c. 994, 64 Stat. 906, 954), which on its face is inapplicable here, Congress enacted such special legislation. The provision states:

> (b) *Period of Limitations.*—In the case of an organization *which would otherwise be exempt under section 101 of the Internal Revenue Code were it not carrying on a trade or business for profit,* the filing of the information return required by section 54 (f) of the Internal Revenue Code (relating to returns by tax-exempt organizations) for any taxable year beginning prior to January 1, 1951, shall be deemed to be the filing of a return for the purposes of section 275 of the Internal Revenue Code (relating to period of limitation upon assessment and collection). * * * The provisions of this subsection *shall not apply to a taxable year of such an organization with respect to which, prior to September 20, 1950,* (1) any amount of tax was assessed or paid, or (2) *a notice of deficiency under section 272 of the Internal Revenue Code was sent to the taxpayer.* [Emphasis added.]

In this case, the Commissioner mailed the notice of deficiency prior to September 20, 1950, namely, on February 20, 1950. Therefore, as the Tax Court stated in *Danz* v. *Commissioner,* 18 T. C. 454, 465, affirmed, *sub nom. John Danz Charitable Trust* v. *Commissioner,* 231 F. 2d 673 (C. A. 9th), certiorari denied, 352 U. S. 828, the 1950 legislation "indicates clearly that returns required by section 54 (f) for taxable years beginning prior to January 1, 1951, were not intended to start the running of the

period of limitations provided in section 275 and it required an act of Congress to make them effective for that purpose under any circumstances." In any event, the 1950 legislation could not apply for there is not present here a taxpayer which would be exempt from tax were it not for the fact that it carried on a trade or business for profit; taxpayer was not entitled to an exempt status on other grounds as well (see *supra*, p. 22.) Thus, the taxpayer's reliance on its Forms 990 to start the statute running would be unavailable even as to taxable years after January 1, 1951.

III

THE AMOUNT OF MEMBERSHIP DUES PAID TO TAXPAYER WAS INCLUDIBLE IN ITS GROSS INCOME FOR THE TAXABLE YEARS IN WHICH SUCH DUES WERE RECEIVED

This issue,[34] which relates to all five of the taxable years here involved (1943 through 1947), concerns the time when taxpayer, on the basis of the accrual method of accounting, is required to include in its gross income the dues paid by its members.

An "active" member's dues, originally in the amount of $10 per year and increased on October 1, 1946, to $12 per year, were payable annually in advance. By paying such dues, the member became entitled during the ensuing twelve months to request and receive such services as taxpayer might make available to its members. The dues which taxpayer received were not segregated or restricted as to dis-

[34] Issue III in the findings of fact and opinion of the Tax Court and in the opinion of the Court of Appeals, but Issue I in taxpayer's brief before this Court.

position, but were deposited in its general bank account.[35]

It is not disputed that the entire amount of membership dues which taxpayer received was includible in its gross income at some time. Taxpayer, however, contends (Br. 23–38) that, although it was entitled to, and without restriction did, receive a member's entire annual dues in advance, it was not required, as an accrual-basis taxpayer, to include the amount of such dues in its gross income for the year of receipt because it had not at that time earned such dues by making available the services to which its members might be entitled. This contention, we submit, not only misconceives the nature of the accrual method of accounting, but also fails to recognize the requirements of the revenue laws that income for tax purposes must be computed on an annual rather than a transactional basis.

[35] Taxpayer did not in any year attempt to establish a reserve for estimated expenses to be incurred in rendering services to members during the following year, and this case does not present any question as to the time when items of deduction claimed by taxpayer should be allowed. In this respect, the case at bar differs from cases relied on by taxpayer (Br. 26, 39, 40), such as *United States* v. *Anderson*, 269 U. S. 422, which involved deduction of reserves for taxes; and *Hilinski* v. *Commissioner*, 237 F. 2d 703 (C. A. 6th), and *Schuessler* v. *Commissioner*, 230 F. 2d 722 (C. A. 5th), both of which also involved deduction of estimated expenses or of a reserve for future expenses. *Pacific Grape Products Co.* v. *Commissioner*, 219 F. 2d 862 (C. A. 9th), upon which taxpayer also relies (Br. 40), presented the question when a sale was consummated and also did not involve deferring accrual of items of gross income beyond the year of receipt.

A. INCLUSION OF THE MEMBERSHIP DUES IN GROSS INCOME FOR THE TAXABLE YEARS IN WHICH TAXPAYER BECAME ENTITLED TO AND DID RECEIVE THEM WAS IN ACCORDANCE WITH THE ACCRUAL METHOD OF ACCOUNTING

By Section 41 of the Internal Revenue Code of 1939 (Appendix, *infra,* p. 67), taxpayers generally were authorized (with exceptions not here relevant) to choose the accounting method by which they would keep their books and compute their income for tax purposes. The effect on gross income of choosing the accrual method, selected by taxpayer in the case at bar, was explained by this Court in *Spring City Co.* v. *Commissioner,* 292 U. S. 182, 184, as follows:

> Keeping accounts and making returns on the accrual basis, as distinguised from the cash basis, import that it is the *right* to receive and not the actual receipt that determines the inclusion of the amount in gross income. When the right to receive an amount becomes fixed, the right accrues.

Under well settled principles of tax law, therefore, it is the right to receive and not the right to retain an item of income which determines its includibility in gross income under the accrual method of accounting. *Brown* v. *Helvering,* 291 U. S. 193; *Spring City Co.* v. *Commissioner, supra.*

Since it is undisputed that the taxpayer in the case at bar not only received a year's membership dues in advance but also had a fixed right to receive them at that time, inclusion of the amount of such dues in gross income for the year of receipt was in accordance

with the accrual method of accounting for tax purposes.[36]

B. IN VIEW OF THE REQUIREMENT OF THE REVENUE LAWS THAT INCOME BE COMPUTED ON AN ANNUAL RATHER THAN A TRANSACTIONAL BASIS, ACCRUAL OF THE MEMBERSHIP DUES AS GROSS INCOME COULD NOT BE DEFERRED BEYOND THE YEARS IN WHICH THEY WERE, UNDER A CLAIM OF RIGHT AND WITHOUT RESTRICTION, RECEIVED

More important here than the particular accounting method which taxpayer selected under Section 41 of the 1939 Code is the requirement of that section that every taxpayer, regardless of his accounting method, compute his income on the basis of an annual accounting period.[37] Since income is by its very nature a flow, rather than a static condition or object, the imposition of a tax upon income requires that points of time be fixed between which the income is to be

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[36] Under the circumstances, the Commissioner is not, as taxpayer argues (Br. 23), contending that it should have accounted for the membership dues on a cash rather than an accrual basis, but rather that it improperly treated the item of dues under the accrual method of accounting which it had selected. See *United States* v. *American Can Co.*, 280 U. S. 412. See also *Beacon Publishing Co.* v. *Commissioner*, 218 F. 2d 697 (C. A. 10th), upon which taxpayer relies (Br. 36–38).

[37] Section 42 (a) of the Internal Revenue Code of 1939 (Appendix, *infra*, p. 67) also provides:

"The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *"

Since in the case at bar the taxpayer did not acquire a right to receive the membership dues prior to the years in which it actually received them, the qualifying portion of this provision is not significant here.

measured for tax purposes. Computation of income on such an annual basis is, as a general matter, essential both to assure the Government a regular and ascertainable production of revenue and to provide a system susceptible of practical operation. See *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365. And since income-producing transactions often extend over a period of more than one year, the annual basis of accounting requires that the computation of income for tax purposes show the net result of all of the taxpayer's transactions *during the year* rather than the net result of any particular transaction which may extend beyond that period. As this Court stated in the *Sanford & Brooks* case *supra*, at pp. 363, 364–365:

> All the revenue acts which have been enacted since the adoption of the Sixteenth Amendment have uniformly assessed the tax on the basis of annual returns showing the net result of all the taxpayer's transactions during a fixed accounting period, either the calendar year, or, at the option of the taxpayer, the particular fiscal year which he may adopt. * * *
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> *   *   *   *   *
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> * * * A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, if combined in a single taxable period, might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction, will be a gain or a loss.

If, instead of this system of annual accounting, a basis of finally ascertained results of particular transactions is to be substituted, Congress and not the courts must provide it. *Burnet* v. *Sanford & Brooks Co.*, *supra*, at p. 367.

This general principle of annual accounting has, in the absence of specific statutory exceptions [33] or long-continued Treasury Regulations, been consistently applied by this Court. In the course of such application, two well-settled judicial doctrines have been adopted to insure that the niceties of commercial accounting do not prevent compliance with this important requirement that income tax for tax purposes be computed on an annual basis. These doctrines are the constructive receipt doctrine, which is not applicable here, and the claim of right doctrine, which, we submit, is both applicable and controlling here.

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[33] Examples of such special legislation in the Internal Revenue Code of 1939 are as follows: Section 43 (in cases of fixed liabilities payable in fixed installments over a series of years, deductions are allowed in a year other than that in which actually paid, as explained in *Security Mills Co.* v. *Commissioner*, 321 U. S. 281); Section 44 (installment basis income); Section 122 (net operating loss deduction); Section 127 (war losses); Section 128 (recovery of unconstitutional federal taxes); Section 162 (b) (division of tax burden between an estate and its beneficiaries); Section 3806 (mitigation of effect of renegotiation of war contracts or disallowance of reimbursement). See also exception expressly authorized in Treasury Regulations with respect to long-term contracts. *Burnet* v. *Sanford & Brooks Co.*, *supra*, p. 366, and Regulations 111, Section 29.42-4. These long-continued Regulations possess the force of law. *Bent* v. *Commissioner*, 56 F. 2d 99 (C. A. 9th). The same is true with respect to the Treasury Regulations treating bond premiums. Treasury Regulations 111, Section 29.22 (a)-17 (2) (a), to which taxpayer also refers in its brief (p. 42).

Under the constructive receipt doctrine, a cash basis taxpayer cannot avoid including in his gross income for the taxable year an item of gross income which he is then entitled to receive but which at his own election he does not then actually receive. Under the claim of right doctrine, neither a cash nor an accrual basis taxpayer can avoid including in his gross income for the taxable year an item of gross income which he has then actually received under a claim of right without restriction as to disposition, even though the right to receive the item may be disputed and even though eventually he may be able to retain only part or none of it. This doctrine was enunciated by this Court in *North American Oil* v. *Burnet,* 286 U. S. 417. There, in a unanimous opinion by Mr. Justice Brandeis income was held taxable in 1917, the year of receipt, even though the litigation on which the right to the money depended was still in progress and was not decided until 1922.[30]

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[30] Pointing out (pp. 421–422, 423–424) that the taxpayer's method of accounting was immaterial, the Court stated (p. 424):

"The net profits earned by the property in 1916 were not income of the year 1922—the year in which the litigation with the Government was finally terminated. They became income of the company in 1917, when it first became entitled to them and when it actually received them. *If a taxpayer receives earnings under a claim of right and without restriction as to its disposition, he has received income which he is required to return, even though it may still be claimed that he is not entitled to retain the money, and even though he may still be adjudged liable to restore its equivalent.* * * * If in 1922 the Government had prevailed, and the company had been obliged to refund the profits received in 1917, it would have been entitled to a deduction from the profits of 1922, not from those of any earlier year." (Emphasis added.)

The principle of the *North American* case has been repeatedly reaffirmed in subsequent decisions of this Court.[40] In *United States* v. *Lewis*, 340 U. S. 590, a

[40] This principle has also been applied in a variety of situations by the lower courts. Nor, since it is a corollary of the principles of annual accounting, is there, as taxpayer suggests (Br. 38), any less basis for its application where items of gross income are received under an undisputed rather than a disputed claim of right. Cases in which the principle has been applied where the right to the income was not in dispute include the following: *Blum* v. *Helvering*, 74 F. 2d 482 (C. A. D. C.), certiorari denied, 295 U. S. 732 (profits realized from stock sales, subject to the obligation to support market with a fund in a stated minimum amount by operating a trading pool for six months subsequent); *Fairmont Creamery Corp.* v. *Helvering*, 89 F. 2d 810 (C. A. D. C.) (interest received by corporation from employees to whom stock had been sold on credit, subject to refund in the event employee quit or was discharged); *Commissioner* v. *Lyon*, 97 F. 2d 70, 73–74 (C. A. 9th) (cash paid to lessor at beginning of ten-year term, subject to refund on termination of lease otherwise than by default of lessee); *First Nat. Bank* v. *Commissioner*, 107 F. 2d 141 (C. A. 6th) (proceeds of a note held taxable notwithstanding contingent liability to repay at maturity if maker failed or if purchase of certain corporate assets was not consummated); *Detroit Consolidated Theatres* v. *Commissioner*, 133 F. 2d 200 (C. A. 6th) (sum received as advance rental deposit); *South Dade Farms* v. *Commissioner*, 138 F. 2d 818 (C. A. 5th) (sum received as advance rentals); *Clay Sewer Pipe Ass'n.* v. *Commissioner*, 139 F. 2d 130 (C. A. 3d) (prepayment for services to be rendered, although under contract recipient may be liable subsequently to return their equivalent); *DeGuire* v. *Higgins*, 159 F. 2d 921 (C. A. 2d) (dividends payable to purchaser of stock subject to possible refund under contract terms); *Capital Warehouse Co.* v. *Commissioner*, 171 F. 2d 395 (C. A. 8th) (prepayment for services, whose cost taxpayer must defray in later year); *Haberkorn* v. *United States*, 173 F. 2d 587 (C. A. 6th) (bonus subsequently returned to employer because of error in calculation of profits, upon which the bonus was based); *Gilken Corp.* v. *Commissioner*, 176 F. 2d 141, 144–145 (C. A. 6th) (sums received as advance rental deposit, security for performance and part payment of purchase price should lessee exercise its option to purchase); *Booth Newspapers*

taxpayer had been mistakenly paid a bonus which he had not earned [41] and which he was subsequently required to return. Pointing out that "the 'claim of right' interpretation of the tax laws has long been used to give finality to that period, and is now deeply rooted in the federal tax system" (p. 592), the Court

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v. *Commissioner*, 201 F. 2d 55 (C. A. 6th) (sum received by cash basis taxpayer as prepaid subscription for newspapers to be delivered in succeeding year); *Gordon's Estate* v. *Commissioner*, 201 F. 2d 171 (C. A. 6th) (sum received under lease with privilege to purchase); *Hyde Park Realty* v. *Commissioner*, 211 F. 2d 462 (C. A. 2d) (sum received as advance rentals).

The decisions make it clear that the rule applies to accrual as well as cash basis taxpayers. See *North American Oil* v. *Burnet*, *supra*, pp. 421–422, 423–424; *id*, 50 F. 2d 752, 755–756 (C. A. 9th); *Brown* v. *Helvering*, 291 U. S. 193, 199–200; *Clay Sewer Pipe Assn.* v. *Commissioner*, *supra*, p. 132; *South Dade Farms* v. *Commissioner*, 138 F. 2d 818 (C. A. 5th).

[41] That the includibility of earnings in gross income depends upon the right to receive them or their actual receipt, rather than the time when they were earned, was explained by this Court in *Guaranty Trust Co.* v. *Commissioner*, 303 U. S. 493, 494, 498, as follows:

"It is true that the acts of Congress taxing income have consistently laid the tax upon the net income received by or accrued to the taxpayer in a 'taxable year,' which is either the calendar year or a different fiscal year, as the taxpayer may elect. But they have never undertaken to limit the income taxable in any one year to that derived from the taxpayer's activities occurring in that or any other single year. The items of gross income and of allowed deductions to be included in the income return, are those of the taxpayer for his taxable year, even though they may have resulted from or be affected by his business transactions of other years. *Burnet* v. *Sanford & Brooks Co.*, *supra*, * * *. Circumstances wholly fortuitous may determine the year in which income, whenever earned, is taxable, and may thus affect the amount of tax. Receipt of income or accrual of the right to receive it within the tax year is the test of taxability, not the time it has taken the taxpayer to earn it nor the duration of his investments which have finally resulted in profit."

held that the amount of the bonus was includible in gross income for the year of receipt. In *Brown* v. *Helvering,* 291 U. S. 193, a taxpayer as general agent for fire insurance companies had received overriding commissions on policies sold subject to a contingent liability to refund a proportionate part of the commissions in the event of subsequent cancellations or reinsurance. This Court held that the entire amount of the overriding commissions was required to be accrued as gross income for the year of receipt, since "[w]hen received, the general agent's right to it was absolute. It was under no restriction contractual or otherwise, as to its disposition, use or enjoyment" (p. 199). In *Heiner* v. *Mellon,* 304 U. S. 271, this Court, holding taxable to partners their distributive shares of profits earned in the liquidation of a business, pointed out (p. 275) that it was of no legal significance that the liquidation was not completed until a subsequent year and that until completion it could not be known whether the business venture taken as a whole had been profitable. In *Security Mills Co.* v. *Commissioner,* 321 U. S. 281, 284, the amount of a processing tax received as part of the cost of goods sold (and treated as such in determining the amount to be taken into gross income from the sales) was held to constitute income in the year of receipt, even though the validity of the tax was then in dispute and the tax was in later years returned to the purchasers. This Court rejected taxpayer's contention, which would have (pp. 285–286) "upset the well-understood and consistently applied doctrine that cash receipts or matured accounts due

on the one hand, and cash payments or accrued definite obligations on the other, should not be taken out of the annual accounting system * * *." See also *Healy* v. *Commissioner,* 345 U. S. 278.

Such decisions firmly establish the proposition that, where an income-producing transaction results in the receipt of an item of income under a claim of right and without restriction as to its disposition, inclusion of the item in gross income for tax purposes is not to be deferred beyond the year of receipt merely because the continuing nature of the transaction requires that in a subsequent period either (a) services be rendered or the use of property be allowed, or (b) expenses be incurred or a portion of the income be returned. In the case at bar, the membership dues paid to taxpayer were received under a claim of right and without restriction as to their disposition. Accordingly, the annual basis of computing income requires that the amount of such dues be included in taxpayer's gross income for the year of receipt, notwithstanding that in a subsequent period it might have to incur expenses in rendering services to members.[42]

Beacon Publishing Co. v. *Commissioner,* 218 F. 2d 697 (C. A. 10th), upon which taxpayer relies (Br. 36–

[42] Taxpayer appears to have abandoned in this Court any contention that the accrual into income of the dues received should be deferred because of the alleged possibility that a small amount might be refunded in the succeeding year because of cancellation of membership. Such alleged liability was contingent in obligation and unsettled in amount and no event necessary for its accrual occurred in the taxable year. See Statement, *supra*, p. 12; *Brown* v. *Helvering*, *supra*.

38), was decided by a divided court subsequent to the Tax Court's decision [43] but prior to the decision by the Court of Appeals below. With deference, we submit that the majority opinion there is in error and Judge Bratton's dissenting opinion expresses the correct view. The reasoning of the majority, it would appear, is inconsistent with the rule which, as the cases cited above demonstrate, this Court and the lower courts have repeatedly followed—namely, that taxable income under the statute is not limited to income computed on a basis of the final outcome of given transactions, save in those special situations where the statute or long-continued Treasury Regulations have made express exceptions.

In any event, the factual situations here and in the *Beacon Publishing Co.* case are distinguishable. There the disputed payments were received by the taxpayer in consideration for newspapers to be delivered in future years, *i. e.,* as payment for a commodity. The cost of goods sold normally reduces the amount of gross receipts taken into gross income from a sale. Internal Revenue Code of 1939, Section 111 (a). In the instant case, on the other hand, the amounts received were in payment for services, the expense of which would normally not reduce the amount of gross receipts to be taken into gross income but would rather be deductible from gross income in arriving at net income. There was also present in the *Beacon Publishing Co.* case an administrative ruling which

[43] However, in a later case, the Tax Court has adhered to its decision in the instant case, and expressed agreement with Judge Bratton's dissent in the *Beacon Publishing Co.* case. *Andrews* v. *Commissioner*, 23 T. C. 1026, 1033.

lent possible support to taxpayer. In I. T. 3369, 1940-1 Cum. Bull. 46, the Internal Revenue Service, recognizing that there were two methods by which accrual basis publishers had been accounting for prepaid subscriptions, had ruled that where a publisher "over a period of years" had reported an aliquot part of the subscription income over the subscription period, it would be permitted to continue to report the income in that manner and would not be required to change this accounting practice, provided that expenses applicable to obtaining the subscriptions were similarly allocated in the subscription period. Publishers who had been reporting the subscription income when received (see G. C. M. 20021, 1938-1 Cum. Bull. 157) were to continue to report the income in that manner. By contrast, no administrative authority in support of taxpayer's position here may be claimed. Again, here the expense of services to a given member might be incurred substantially in the first month of membership, *i. e.,* for emergency road service and travel information; in *Beacon Publishing Co.,* on the other hand, the newspapers would be published daily on a regular basis throughout the subscription period.

Finally, the action of Congress in enacting Sections 452 and 462 of the Internal Revenue Code of 1954 (26 U. S. C. 1952 ed., Supp. II, Secs. 452 and 462) and in subsequently repealing those sections makes clear the correctness of the Commissioner's position here under Sections 41 and 42 (a) of the Internal Revenue Code of 1939. In Sections 452 and 462 of the 1954 Code, Congress enacted exceptions to the

general requirement that income be computed for tax purposes on an annual rather than a transactional basis. This was done by permitting taxpayers, at their election, to postpone the reporting of prepaid income and to establish reserves for estimated expenses. That Congress intended these provisions to represent a change in the law with respect to the tax treatment of advance payments for services to be rendered is made clear by the report of the Senate Committee on Finance, which states (S. Rep. No. 1622, 83d Cong., 2d Sess., pp. 62–63; 3 U. S. C. Cong. & Adm. News (1954) 4629, 4694):[44]

> *Under present law payments received in advance for the use of property in future years or for services to be rendered in future years are includible in the income of the recipient in the year they are received. This is true regardless of the taxpayer's method of accounting.* However, well-established accounting procedure provides that in the case of those on an accrual accounting system payments for rentals, club dues, warehouse fees, and the like should be included in income for the year in which income is earned and in the year in which the related

[44] The Senate Finance Committee also referred to the type of problem presented in the *Beacon Publishing Co.* case and this case as follows (S. Rep. No. 1622, 83d Cong., 2d Sess., p. 301; 3 U. S. C. Cong. & Adm. News (1954), 4629, 4940):

"Under the 1939 Code, regardless of the method of accounting, with minor exceptions established by regulations or administrative practice, amounts are includible in gross income by the recipient not later than the time of receipt if they are subject to free and nonrestricted use by the taxpayer. *even though the payments are for goods or services to be provided by the taxpayer at a future time.*" (Emphasis added.)

> expenses are incurred. This is not necessarily the year of receipt.
>
> The House and your committee's bill permit accrual-basis taxpayers to defer the reporting of advance payments as income until the year, or years, in which, under the taxpayer's regular method of accounting, the income is earned. [Emphasis added.]

The loss of revenue as the result of the enactment of Sections 452 and 462 of the 1954 Code was found to be so serious that, at the instance of the Treasury Department, those sections were repealed by the Act of June 15, 1955, c. 143, 69 Stat. 134.

Thereafter, the Secretary of the Treasury wrote the Chairman of the Committee on Ways and Means that the repeal of Section 452 would not be considered by the Department as either the acceptance or the rejection by Congress of the *Beacon Publishing Co.* decision or any other judicial decisions.[46] In short, the recognized effect of the repeal was to restore prior law. The committees of both Houses indicated that the subject was to be studied further with a view to

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[46] H. Rep. No. 293, 84th Cong., 1st Sess., pp. 4–5 (1955-2 Cum. Bull. 852, 855):

"Furthermore, the Treasury Department will not consider the repeal of section 452 as any indication of congressional intent as to the proper treatment of prepaid subscriptions and other items of prepaid income, either under prior law or under other provisions of the 1954 code. In other words, the repeal of section 452 will not be considered by the Department as either the acceptance or the rejection by Congress of the decision in *Beacon Publishing Co.* v. *Commissioner* (218 F. (2d) 697, C. A. 10, 1955) or any other judicial decisions."

legislation at an early date.[46] Certainly this recent experience in dealing with these complex problems emphasizes the wisdom of leaving to Congress the decision of providing for exceptions to the settled annual accounting principle and claim of right doctrine.[47]

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[46] S. Rep. No. 372, 84th Cong., 1st Sess., p. 6 (1955-2 Cum. Bull. 858, 861) declared:

"Your committee desires to make its position clear that it expects to report out legislation dealing with prepaid income and reserves for estimated expenses at an early date. As indicated above, the existing rulings of the Treasury Department and the court decisions dealing with estimated expenses and prepaid income are now in such a state of confusion and uncertainty that in the opinion of your committee legislative action is required on these subjects. In addition, your committee believes that it is essential that the income tax laws be brought into harmony with generally accepted accounting principles. Moreover, your committee believes that the present status, where some taxpayers are able to defer prepaid income while others are not, is inequitable and should not be allowed to continue. In order to eliminate this uncertainty and discrimination, definite rules must be written into the income tax law. For these reasons your committee plans to begin studies in the near future to devise proper substitutes for the sections now being repealed."

H. Rep. No. 293, 84th Cong., 1st Sess., p. 4 (1955-2 Cum. Bull. 852, 854) stated:

"In view of the testimony received from taxpayers by your committee and the recognized desirability of conforming tax accounting to business accounting, your committtee has instructed the staff of the Treasury Department and the staff of the Joint Committee on Internal Revenue Taxation to make studies of these accounting problems in an effort to provide conformance of tax and business accounting without the transitional revenue loss. It has further requested each staff to report any suggested solutions to the committee as soon as feasible."

[47] The understanding by Congress that a change in the settled rules in this field should be made by legislation is supported by its enactment of Section 1341 of the Internal Reve-

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the judgment of the Court of Appeals is correct and should be affirmed.

J. LEE RANKIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
JOHN N. STULL,
I. HENRY KUTZ,
JOSEPH F. GOETTEN,
Attorneys.

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nue Code of 1954 (26 U. S. C. 1952 ed., Supp. II, Sec. 1341). The detailed terms of this section further demonstrate the wisdom for provision to be made by legislative action.

APPENDIX

Internal Revenue Code of 1939:

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 41.)

SEC. 42. PERIOD IN WHICH ITEMS OF GROSS INCOME INCLUDED.

(a) [As amended by Sec. 114 of the Revenue Act of 1941, c. 412, 55 Stat. 687, 697] *General Rule.*—The amount of all items of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under section 41, any such amounts are to be properly accounted for as of a different period. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 42.)

SEC. 52. CORPORATION RETURNS.

(a) *Requirement.*—Every corporation subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for

the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 52.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

(b) *To Determine Liability to Tax.*—Whenever in the judgment of the Commissioner necessary he may require any person, by notice served upon him, to make a return, render under oath such statements, or keep such records, as the Commissioner deems sufficient to show whether or not such person is liable to tax under this chapter.

* * * * *

(f) [As added by Sec. 117 (a) of the Revenue Act of 1943, c. 63, 58 Stat. 21, 36] Every organization, except as hereinafter provided, exempt from taxation under section 101 shall file an annual return, which shall contain or be verified by a written declaration that it is made under the penalties of perjury, stating specifically the items of gross income, receipts, and disbursements, and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner, with the approval of the Secretary, may by regulations prescribe, and shall keep such records, render

under oath such statements, make such other returns, and comply with such rules and regulations as the Commissioner, with the approval of the Secretary, may, from time to time prescribe. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 54.)

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this chapter—

* * * * *

(9) Clubs organized and operated exclusively for pleasure, recreation, and other nonprofitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder;

* * * * *

(26 U. S. C. 1952 ed., Sec. 101.)

SEC. 275. PERIOD OF LIMITATION UPON ASSESSMENT AND COLLECTION.

Except as provided in section 276—

(a) *General Rule.*—The amount of income taxes imposed by this chapter shall be assessed within three years after the return was filed, and no proceeding in court without assessment for the collection of such taxes shall be begun after the expiration of such period.

* * * * *

(26 U. S. C. 1952 ed., Sec. 275.)

SEC. 276. SAME—EXCEPTIONS.

(a) *False Return or No Return.*—In the case of a false or fraudulent return with intent to evade tax or of a failure to file a return the tax may be assessed, or a proceeding in court

for the collection of such tax may be begun without assessment, at any time.

(b) *Waiver.*—Where before the expiration of the time prescribed in section 275 for the assessment of the tax, both the Commissioner and the taxpayer have consented in writing to its assessment after such time, the tax may be assessed at any time prior to the expiration of the period agreed upon. The period so agreed upon may be extended by subsequent agreements in writing made before the expiration of the period previously agreed upon.

* * * * *

(26 U. S. C. 1952 ed., Sec. 276.)

SEC. 3791. RULES AND REGULATIONS.

* * * * *

(b) *Retroactivity of Regulations, or Rulings.*—The Secretary, or the Commissioner with the approval of the Secretary, may prescribe the extent, if any, to which any ruling, regulation, or Treasury Decision, relating to the internal revenue laws, shall be applied without retroactive effect.

(26 U. S. C. 1952 ed., Sec. 3791.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

SEC. 29.52–1. *Corporation Returns.*—Every corporation not expressly exempt from tax must make a return of income, regardless of the amount of its net income. In the case of ordinary corporations, the return shall be on Form 1120. * * *

SEC. 29.101–1 [As amended by T. D. 5381, 1944 Cum. Bull. 188, 189] *Proof of Exemption Prior to January 1, 1943.—Annual Returns for Accounting Periods Beginning Prior to Janu-*

ary 1, 1943.—A corporation is not exempt merely because it is not organized and operated for profit. In order to establish its exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or a questionnaire as set forth below. An organization claiming exemption under section 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following questionnaire forms may be obtained from any collector: For corporations claiming exemption * * * under section 101 (9), Form 1025 * * *. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization. An organization claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall also file with the other information specified herein a return of information on Form 990 relative to the business of the organization for the last complete year of operation * * *

* * * * *

The collector, upon receipt of the affidavit, or questionnaire, and other papers, will examine them as to completeness and will forward completed documents to the Commissioner for decision as to whether the organization is exempt. In addition to the information speci-

fied herein, the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 101, and when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

When an organization (other than a mutual insurance company) has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created, except that every organization exempt or claiming exemption under section 101 (5), (6), except organizations organized and operated exclusively for religious purposes, (7), (8), (9), or (14) shall file annually returns of information on Form 990 with the collector for the district in which is located the principal place of business or principal office of the organization * * *.

Collectors will keep a list of all organizations held to be exempt to the end that they may occasionally inquire into their status and ascertain whether or not they are observing the conditions upon which their exemption is predicated.

An organization which is exempt, under section 101 and the regulations thereunder, from filing returns of income is not, however, relieved from the duty of filing returns of information (see sections 147 and 148).

SEC. 29.101-2 [As added by T. D. 5381, *supra*]. *Proof of Exemption on or after January 1, 1943.—Annual Returns for Accounting Periods Beginning on or After January 1, 1943.*—(*a*) *Proof of exemption.*—An

organization is not exempt from tax merely because it is not organized and operated for profit. In order to establish exemption it is necessary that every organization claiming exemption file with the collector for the district in which is located the principal place of business or principal office of the organization an affidavit or questionnaire as set forth below. An organization claiming exemption under section 101 (1), (3), (4), except a bona fide credit union, (6), (7), (8), (9), (10), (12), (14), or (16) shall file the form of affidavit or questionnaire appropriate to its activities, filled out in accordance with the instructions on the form or issued therewith. Copies of the following forms may be obtained from any collector: For organizations claiming exemption * * * under section 101 (9), Form 1025 * * *. To each such affidavit or questionnaire shall be attached a copy of the articles of incorporation, declaration of trust, or other instrument of similar import, setting forth the permitted powers or activities of the organization, the by-laws or other code of regulations, and the latest financial statement showing the assets, liabilities, receipts, and disbursements of the organization.

* * * * *

(b) * * *

In addition to the information specifically called for by these regulations the Commissioner may require any additional information deemed necessary for a proper determination of whether a particular organization is exempt under section 101, and when deemed advisable in the interest of an efficient administration of the internal revenue laws he may in the cases of particular types of organizations provide additional questionnaires or otherwise prescribe the form in which the proof of exemption shall be furnished.

* * * * *

(c) *Collector's duties with respect to proof of exemption.*—The collector, upon receipt of the affidavit or questionnaire and other papers constituting the proof of exemption by an organization claiming exemption from tax under section 101, will forward completed documents to the Commissioner for decision as to whether the organization is exempt.

* * * * *

(e) *Requirement of annual returns.*—For accounting periods beginning after December 31, 1942, every organization exempt from tax under section 101, regardless of the amount or source of its income or receipts and irrespective of whether it is chartered by, or affiliated or associated with, any central, parent, or other organization, except organizations specifically exempted from filing annual returns by section 54 (f) (see subsection (h) of this section), shall file annually with the collector for the district in which is located the principal place of business or principal office of the organization a return of information on Form 990 (revised May, 1944) specifically stating the items of gross income, receipts, and disbursements and such other information as may be prescribed by the Commissioner in the instructions on the form or issued by him therewith. * * *

* * * * *

(g) *Date for filing annual returns.*—The annual return of information, Form 990 (revised May, 1944), for accounting periods beginning after December 31, 1942, but ending prior to April 1, 1944, shall be filed on or before August 15, 1944, and for accounting periods beginning after December 31, 1942, but ending after March 31, 1944, shall be filed on or before the 15th day of the fifth full calendar month following the close of the period for which the return is required to be filed.

* * * * *

(i) *Collector's records.*—Collectors will keep a list of all organizations held to be exempt from tax to the end that they may occasionally inquire into their status and ascertain whether or not they are (1) observing the conditions upon which their exemption is predicated, and (2) annually filing returns on Form 990 (revised May, 1944) if they are required to file such returns.

(j) *Records, statements, and other returns of tax-exempt organizations.*—An organization which has established its right to exemption from tax under section 101 and has also established that it is not required to file annually the return of information on Form 990 (revised May, 1944) shall immediately notify in writing the collector for the district in which is located its principal office of any changes in its character, operations, or purpose for which it was originally created.

Every organization which has established its right to exemption from tax, whether or not it is required to file an annual return of information, shall submit such additional information as may be required by the Commissioner for the purpose of enabling him to inquire further into its exempt status and to administer the provisions of section 54 (f) and this section. For requirement as to keeping of permanent books of account or records, see section 29.54–1.

An organization which has established its right to exemption from tax under section 101, including an organization which is relieved under section 54 (f) and these regulations from filing returns of income or annual returns of information, is not, however, relieved from the duty of filing other returns of information (see sections 147 and 148).

Sec. 29.101 (9)–1. *Social Clubs.*—The exemption granted by section 101 (9) applies to practically all social and recreation clubs which are supported by membership fees, dues, and

assessments. If a club engages in traffic, in agriculture or horticulture, or in the sale of real estate, timber, etc., for profit, such club is not organized and operated exclusively for pleasure, recreation, or social purposes. Generally, an incidental sale of property will not deprive the club of the exemption.